S. HRG. 113–242

REBUILDING THE NATION'S INFRASTRUCTURE: LEVERAGING INNOVATIVE FINANCING TO SUPPLEMENT FEDERAL INVESTMENT

HEARING

BEFORE THE

SUBCOMMITTEE ON SURFACE TRANSPORTATION AND MERCHANT MARINE INFRASTRUCTURE, SAFETY, AND SECURITY

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

SEPTEMBER 24, 2013

Printed for the use of the Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE
87–537 PDF WASHINGTON : 2014

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

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REBUILDING THE NATION'S INFRASTRUCTURE: LEVERAGING INNOVATIVE FINANCING TO SUPPLEMENT FEDERAL INVESTMENT

TUESDAY, SEPTEMBER 24, 2013

U.S. SENATE,
SUBCOMMITTEE ON SURFACE TRANSPORTATION AND
MERCHANT MARINE INFRASTRUCTURE, SAFETY AND SECURITY,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:35 p.m., in room SR–253, Russell Senate Office Building, Hon. Mark Warner, Chairman of the Subcommittee, presiding.

OPENING STATEMENT OF HON. MARK WARNER, U.S. SENATOR FROM VIRGINIA

Senator WARNER. Thank everybody for coming, and I'll call to order this hearing of the Surface Transportation Subcommittee.

This is my first time chairing this subcommittee, and, as a former governor, it's a committee I look forward to chairing. I wish there might have been another way for me to get this position. I know, as—and I know Senator Blunt feels the same—this is the first time I'll be chairing, because of the passing of our friend and colleague Senator Lautenberg. He was a great Senator and a great personal friend of mine and of this committee's.

But, you know—and I—again, I want to apologize to the witnesses and to Senator Blunt for starting 5 minutes late; that's not necessarily the way I wanted to start my tenure as Chair—but today we're going to get—and, for everyone here, we're going to get at least a brief respite from the otherwise dysfunction that seems to be floating in the ether around Capitol Hill. We're going to be here to talk about challenges we face with our nation's infrastructure, what some potential tools that we could use to actually make some progress and in an area that—where, I think, over the coming weeks, we may be able to surprise a lot of people with an awful lot of bipartisan agreement.

Again, some facts that most of the witnesses all know, and I know Senator Blunt and I have spent a great deal of time talking about, if we look at our nation's infrastructure today on any kind of historic basis, we're at all-time lows. As a proportion of our GDP, we are down to roughly half of what we're investing as a percent of our GDP, versus the 1970s. We're down roughly a little lower than 2 percent. And some of you may correct me on that, but that's

the number I continue to use. China and India, they're more up in the 8 and 9 percent range. Even the Europeans, who've also got a mature economy, are spending double as a percent of their GDP than what we are.

And let me say, MAP–21, on the transportation side or the traditional highway side, put us on a solid policy reform, and put in some performance measures that I think were long needed. It also was a bill that was basically flat-funded, and, out of that flat funding, my numbers say about 27 cents of every dollar was taken, not from the Highway Trust Fund, but, from an old governor's parlance, from the General Fund. So, it was being taken from defense, it was being taken from education, it was being taken from research or from Medicare.

The recent CBO study found that the Highway Trust Fund goes broke in 2015. We've transferred 41 billion from the General Fund since 2008, and, in 2015, we'll actually need to transfer another 14 billion just to get through that year. This is not a—I said we—I wasn't going to be gloom and doom; we are going to get to the positive, upside of this.

And I understand—and I talked to her briefly, one of the reasons why I was a little late—colleague Senator Boxer, over at EPW, will be holding a hearing tomorrow on the solvency of the Highway Trust Fund. I applaud that committee's work. And everything we can do to find a larger, more permanent funding source for the Highway Trust Fund, I look forward to working with—in a bipartisan way, with that.

But, one of the things—and today's subject of the hearing is—we can supplement traditional funding streams with innovative financing mechanisms, public-private partnerships, and other ways of bringing private sector capital in to match and leverage our existing Federal and State and local funding streams. Senator Blunt and I have been talking about this for some time, and we'll have more to say about this in the coming weeks. But, as we talk about financing tools, let me, at least from my standpoint, say what we are talking about doing or creating, and what we're not talking about doing and creating.

First, any kind of financing authority that might be proposed, going forward, is not a full solution set. It does not replace the need for permanent transportation funding. But, it is a very important tool in the toolbox, and it's a tool in the toolbox that I believe could supplement very successful existing financing tools, like TIFIA and some of the new WIFIA-type projects that are already in place.

Anything that we're talking about, there's been past proposals in this area, would be new. Past proposals had, perhaps, a broader, more governmental-type vision than some of the things we've been talking about. If there was any future legislation, there would not be legislation that would include grants, it would only be loans and, candidly, more loan guarantees. It would not be looking at creating some new giant bureaucracy. It would not be trying to get into the area of energy generation or financing for public buildings. It would really be about more traditional infrastructure. And it would have to meet the criteria of being paid for and self-sufficient once it was initially capitalized. And I think there are a number of models around the world, as well as even within the Federal

Government—Export-Import Bank, for example—that we could use.

Another area that I think of enormous importance as we look at existing public financing activities within the Federal Government is, how do we create the kind of public sector expertise in a single location or—where that project finance expertise can be located—and I know we've got some experts from—I won't call Carlyle "Wall Street," but Morgan Stanley—from high-level financiers—how do we, on the taxpayers' side, have the expertise to go against—or go toe-to-toe, at least—to make sure that the public sector gets the kind of protections and fair and good deals that we need? I don't think we have that kind of a expertise right now.

And one of the things we've also been talking about is, while oftentimes infrastructure is talked about in needs or talked about in major areas, metropolitan areas, one of the things that I think some of the previous proposals lacked was enough focus on the fact that large swaths of our rural communities have enormous infrastructure needs, as well. So, any future financing authority or approach, I think would have to broaden its appeal for rural areas.

Finally, I'd like to say that, you know, we've seen the Fed say they're going to continue QE—the quantitative easing—for some additional time. We may have different views about the effect of that. But, one thing I think none of us would deny, no matter what we feel about the Fed's policies, are—interest rates are not going to remain at these historic lows forever; they are going to start creeping back up. And for us not to take advantage of this period of time when credit is relatively cheap, on any kind of historic basis, would be a missed opportunity, I think, of enormous mistake.

So, with that, I'd like to ask my Ranking Member and good friend, somebody who we've been working very closely on this idea, Senator Blunt, for any opening comments.

STATEMENT OF HON. ROY BLUNT, U.S. SENATOR FROM MISSOURI

Senator BLUNT. Well, thank you, Senator Warner. And I look forward to working with you on this committee.

You know, since the very founding of the government, infrastructure and just how much the Federal Government could do has been one of the debates that's defined the Federal system. A hundred and fifty years ago, the previous Congress had just passed the Intercontinental Railroad Act, and Federal Government was doing what it needed to do to connect the country in that way. And clearly, all of us who travel around the United States, or, frankly, live anywhere in the United States, realize that the infrastructure is stressed and it needs to be a focus.

I just mentioned to Secretary Mineta that I was in Brazil for a few days in August with Secretary Vilsack. And in the 10 years I've been going to Brazil, one of the things I saw was, their productive capacity has greatly increased, but their infrastructure no longer handles what they're able to produce.

That very same thing is happening, and can continue to happen, to us. You can't be competitive if you don't have an infrastructure that allows you to be competitive. You can't be competitive in a

global economy if you're not connected the right way to the right places that let you get to that global economy.

Senator Klobuchar and I have worked a lot on travel and tourism. If you don't have the kind of facilities you need, infrastructure-wise, not only do people from other countries not visit your country and travel the way they otherwise would, but people in the country don't travel. The connectedness of families, the opportunity to understand and be part of the whole country is very much dependent on what happens in infrastructure. That's been a cooperative effort, from the very first days of the Federal Government, between the Federal Government and State and local governments. That's going to continue to be the case.

And any legislature in America would be delighted to have this panel. It's a great panel. And, Chairman, I'm glad you've put it together and we've got it here today, because we want to talk about and begin to better understand all of the different ways that we can do things that encourage the enhancement of how we lend, how we travel, how we stay connected to each other, and how we advance our own interests and our economic interests by doing a better job with that.

And so, the Chairman and I are working on some proposals. One of the reasons we wanted to have this panel today was to hear what you had to say about these topics, generally, so that we can further hone down the efforts that we hope to make, collectively and as a Senate and as a Congress, to create new tools and to make the old tools work better.

And so, again, thank you all for being here. And, Chairman, thank you for your leadership on this. And I look forward to being part of this subcommittee and this whole committee with your leadership on the surface transportation issues.

Senator WARNER. Thank you, Senator Blunt.

I want to get to the panel, but I just want to acknowledge Senator Klobuchar, who can speak firsthand. This is an area that she's been interested in for a long time. And we saw, not too long ago, the tragedy in Minnesota, about not meeting up with our infrastructure needs, so——

Do you want to add anything, Senator?

STATEMENT OF HON. AMY KLOBUCHAR, U.S. SENATOR FROM MINNESOTA

Senator KLOBUCHAR. Well, thank you.

I just want to—appreciate that you brought up the rural issues, Senator Warner. And I can't think of a better person to lead this subcommittee, and, along with Senator Blunt, that we could actually get something done, here.

I think Secretary Mineta and our panelists know there's long been bipartisan support for transportation issues. It is there. And so, we just have to figure out the right way to do it. And the work with infrastructure banks—I love the River Act, the idea of how—the industry being willing to pay higher fees to help with our locks and dams. We have a lot going on with freight. And there's just a lot of possibilities.

And I view this whole thing as the way we get the economy going, because it's part of exports, it's part of getting goods to mar-

ket. And if we're going to double our exports in 5 years, the only way we can get there is if we have a good transportation system that carries those goods to market.

So, thank you.

Senator WARNER. I'm going to move to the panel, although I would acknowledge, as well, that the—I think, in the last 30 or 40 years, the two states that have actually had the real results of infrastructure disasters have been Connecticut and Minnesota. I remember, in particular—it wasn't that long ago.

Senator BLUMENTHAL. That's right, Mr. Chairman. And your home state appreciates your having this hearing.

[Laughter.]

Senator WARNER. Let the record show that——

Senator BLUMENTHAL. And thank you, to the panel.

Senator WARNER.—I'm a proud Virginian.

[Laughter.]

Senator WARNER. And moving forward with that, we're going to get to the panel.

I'm going to—because we all spoke a little long, I'm going to skip the very distinctive, long introductions of each of the members of this panel. I'm going to simply introduce them with one line each and then let them proceed.

Obviously, we're going to start with former Secretary, former Member of Congress, Norm Mineta, who was Secretary of Transportation under President Bush and Secretary of Commerce under President Bill Clinton, and is a dear friend of all of the members of this panel; Matt Connelly, who is going to bring our users' perspective, Vice President of Transportation for UPS, a nationwide company obviously very, very concerned with transportation; Jack Basso, a Principal of Peter J. Basso and Associates, but that may be working for now, but anybody who's been involved in transportation over the last 30 years knows that Jack Basso was the heart and soul of AASHTO for a long time and knows more about transportation—has forgotten more about transportation than I'll ever know in my whole lifetime; Robert Dove, who's one of the managing directors of Carlyle Investment—Infrastructure Partners—Carlyle, here in D.C.—and brings both a national and international perspective to this issue; and Perry Offutt, the Managing Director for Infrastructure Banking at Morgan Stanley—again, one of the national and international leaders.

We're very happy to have all of these distinguished members of the panel. And we'll just start with Secretary Mineta and go down the list. And we'd ask you all to try to keep your comments to about 5 minutes each, because we've got lots of questions for you.

STATEMENT OF HON. NORMAN Y. MINETA, FORMER UNITED STATES SECRETARY OF TRANSPORTATION, FORMER UNITED STATES SECRETARY OF COMMERCE

Mr. MINETA. Thank you very much, Mr. Chairman, members of the Committee. And thank you for your invitation to appear before the Subcommittee here today.

Senator Warner, please accept my congratulations on your becoming the Chair of this subcommittee. Your experience as the Chief Executive of the Commonwealth of Virginia and your accom-

plishments as Governor really do show the accomplishments and innovative financing that you were able to accomplish and that we should see, on a bipartisan level, at the national level.

And, of course, my friend Senator Blunt, thank you for your work on the Subcommittee and your work on the bipartisan legislation known as the Revitalization of American Manufacturing and Innovation Act. Both show your knowledge of the relationship between manufacturing and our nation's transportation system.

In discussing infrastructure financing and what role a national financing authority should have, I would like to identify some of the existing challenges that we currently face. Our nation has challenges that have—and our nation has not developed a bipartisan set of financing models which can be used by Federal, State, and local governments. The unfortunate truth is, projects using innovating financing are more the exception than the rule.

First, both the public and private sectors have not been successful in communicating with one another about innovative financing models. Too often, public officials have had to rely on financial advisors from the public finance community, who are now well-versed in these new models. Issues like lifecycle cost and other issues have not received the kind of attention that they should.

And the private sector was too slow to recognize that a business-to-business model neither successfully addressed the needs of the public sector nor was effective in communicating with public officials. Too often, they appeared to be interested in a de facto privatization model and not a genuine partnership.

Many traditionalists used this time to derail a constructive policy discussion. Instead of looking for ways to create real partnerships that took the best of both systems, the discussion devolved into traditional battles of public versus privatization, organized labor versus Wall Street, and rural versus urban and suburban. Frankly, none of these labels apply. There have been collaborations, which have broken every one of these inaccurate criticisms.

This recent history of this false debate has contributed to a second challenge, and that is managing political risk. The private sector invests only after assessing the degree of risk it faces on getting a return on an investment. State and local governments should have a process in which analysis of the right model has an identifiable and fair system of review and approval. Virtually every infrastructure stakeholder is disinclined to invest funds into a potential project if the institutional process is set up to be easily manipulated to derail a project.

A third challenge is, private investors often have money that is too expensive. The return on investment, or ROI, is often in the double digits, and frequently that just can't compete with other forms of financing. So, what looks like a small pipeline of candidates for innovative financing is often just public officials using cheaper money with lower interest rates.

And a fourth hurdle is a familiar one. Whether it's the project design process, procurement practices, or environmental reviews, the timeline between a project being funded and when it is completed is just too long. Procurement between environmental and environmental safeguards need to be strong. But, the system is too easy to manipulate into unacceptable delays, and we cannot expect

investors to tie up their funds in projects that are locked in a process that is inefficient and unpredictable. And this is a problem that affects every citizen, but it is particularly costly when developing alternative funding models.

Mr. Chairman, this committee can address every one of these challenges that I have identified, address them now, even while you are developing a national financing authority.

First, this subcommittee can serve as resource for constructive solution-based education of alternative funding models. Mr. Chairman, you are a true pioneer in this area, and, with your leadership, you can help Members of Congress in both houses learn more about the benefits of these new models.

Also, Congress can find, and should insist, that Federal agencies can—that Federal agencies make it a priority to work with State and local governments to develop these models and serve as a validator in working with their citizens.

Third, I would encourage the Subcommittee to develop a structure that takes advantage of multiple equity sources. Pension funds are becoming increasingly sophisticated at infrastructure investment. And State infrastructure banks, community banks, and even engineering and construction companies can provide cheaper equity to projects in a variety of infrastructure modes.

Mr. Chairman, there are several stakeholders in this process who can help the Committee and point to past examples of success, Federal systems that can be improved, and new innovative models that hold a great deal of promise. Mr. Robert Dove, who the Committee will hear from today, created a project in Connecticut in which his fund, partnered with a Republican Governor and organized labor's SEIU in a State transportation project. My former DOT colleague, Jack Basso, who is here before the Committee, is a subject-matter expert in identifying ways that Federal agencies can gain additional leverage from existing models, like TIFIA and TIGER grants, in order to bring more investment into the system.

Your subcommittee, Mr. Chairman, has received written testimony from my former Transportation chief of staff, John Flaherty and Jill Eicher, who was an innovator in financing more infrastructure with pension funds, and I recommend the Subcommittee review the models that they have outlined to you.

And finally, Mr. Chairman, I would encourage the Subcommittee to reach out and support leaders in the Administration who have made these issues of priority. Agriculture Secretary Tom Vilsack has his staff doing some outstanding work, developing ways to use the USTA resources to get more private investment in rural America.

So, Mr. Chairman and Senators, best wishes in your efforts. Thank you for inviting me here today. And thank you for your efforts to address this critical need in our great nation.

[The prepared statement of Mr. Mineta follows:]

PREPARED STATEMENT OF HON. NORMAN Y. MINETA, FORMER UNITED STATES SECRETARY OF TRANSPORTATION, FORMER UNITED STATES SECRETARY OF COMMERCE

Mr. Chairman and Members of the Committee, thank you for your invitation to appear before the Subcommittee here today. And Mr. Chairman, thank you very much for those kind comments.

Senator Warner, please accept my congratulations on your becoming Chair of this Subcommittee. Your experience as the chief executive of the Virginia Commonwealth, and your accomplishments as Governor in innovative transportation funding policies are bipartisan examples of what is needed at the national level.

Senator Blunt, thank you for your work on this Subcommittee and your leadership on such bipartisan legislation as the "Revitalize American Manufacturing and Innovation Act of 2013." Both show your knowledge of the interrelationship between transportation and our Nation's manufacturing.

In discussing infrastructure financing, and what role a national financing authority should have, I would like to identify some of the existing challenges we currently face. Our nation has not developed a bipartisan set of financing models which can be used by federal, state, and local governments. The unfortunate truth is projects using innovative financing are more the exception than the rule.

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This recent history of this false debate has contributed to a second challenge: managing political risk. The private sector must invest only after assessing the degree of risk it faces on getting a return on its investment. State and local governments should have a process in which analysis of the right model has an identifiable and fair system of review and approval. Virtually every infrastructure stakeholder is disinclined to invest funds into a potential project if the institutional process is set up to be easily manipulated to derail a project.

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And finally, I would encourage the Committee to reach out and support leaders in the Administration who have made these issues a priority. Agricultural Secretary Tom Vilsack has his staff doing some outstanding work developing ways to use the USDA resources to get more private investment in rural America.

So, Mr. Chairman, and Senators, best wishes in your efforts. Thank you for inviting me here today, and thank you for your efforts to address this critical need for our nation.

Senator WARNER. Thank you, Secretary Mineta, and thank you for all the great work you've done for our country in so many different roles.

Mr. Connelly.

STATEMENT OF MATT CONNELLY, VICE PRESIDENT, TRANSPORTATION, UPS

Mr. CONNELLY. Chairman Warner, Ranking Member Blunt, and members of the Subcommittee, thank you for the opportunity to testify.

At UPS, we use every mode of transportation, so we can offer a broad perspective on ways to improve and fund America's transportation infrastructure. Each day at UPS, we deliver 16.3 million packages to 8.8 million customers. We serve every address in North America, and we operate in more than 220 countries and territories.

It is estimated that, at any given time, the economic value of the goods and services that move in the UPS supply chain equate to 6 percent of our country's gross domestic product, 2 percent of our global GDP. Our delivery fleet includes more than 96,000 commercial vehicles, which traveled more than 2.3 billion miles on American roads and highways last year. We operate one of the largest airlines in the world, with more than 560 owned and leased aircraft, and each year we move over 500,000 TEUs, or ocean containers, via our UPS ocean freight services. And we are the largest—one of the largest customers of American freight railroads, moving 3,000 trailers and containers by intermodal every day.

With that kind of volume and breadth of our multimodal network, finding ways to eliminate bottlenecks is essential for us. Congestion and inefficiency impose real costs in our company, our customers, and America's competitiveness. For example, if every UPS delivery vehicle is delayed just 5 minutes per day, it would cost UPS an additional $105 million of operating costs annually.

The Texas Transportation Institute found that congestion cost the U.S. economy $121 billion in 2011. In today's just-in-time manufacturing environment, delays in the flow of inputs and finished products make American companies less competitive and eventually force consumers to pay higher prices.

Until our infrastructure is modernized, America's economy will fall short of its full potential. That's why UPS supports a strong Federal role in transportation policy to ensure coordination and national focus. For example, MAP–21 included a focus on freight. And we encourage a greater commitment to that idea in the next surface transportation bill, along with larger investment in projects of national and regional significance.

Overall, what does 21st century infrastructure look like? It provides sufficient capacity, runs seamless across modes, and is adequately funded today and into the future.

It starts with having sufficient capacity to meet the needs of all users. According to the American Trucking Association, domestic freight demand will double by 2050. Truck freight demand will increase by 25 percent in just the next 12 years. America's capacity must keep pace with the rising demand.

Second, a modern infrastructure includes seamless connections between modes. Over the years, America's transportation system has been built by mode in silos. It's a patchwork. What we need is a network and a seamless system where freight can move between modes by the most efficient and economical path. At UPS, we ship packages between trucks, rail, seaports, and airports to find the most efficient, economical, and environmentally friendly route. When those intermodal connections are backed up, it hurts our customers and it hurts our country's productivity. So, improving these connections between modes is critical.

And finally, our transportation infrastructure must be adequately funded. At UPS, we believe every funding option should be examined. Specifically, we believe that existing user fees should be increased and new user fees should be considered, as long as they are dedicated solely to transportation. For example, we favor increasing the Federal fuel tax, indexing it to inflation, and dedicating that revenue exclusively to the Highway Trust Fund. Not many companies will stand up and say, "Tax us more for the transportation infrastructure we use," but that's exactly what UPS is saying, as long as the funding is not diverted to other uses. We want to be part of the solution, and we're willing to do our part.

Further, we believe a tax on vehicle miles traveled, or VMT, should be considered. This subcommittee is studying an infrastructure financing authority, an idea that we are open to exploring. So far, we have withheld judgment, because as always, the devil is in the details. We would look for dedicated funding to improve the flow of goods, such as projects that address highway infrastructure, freight rail fluidity, air traffic management, seaport connectivity, and related challenges.

Some have suggested adding tolls on interstate highways. It's an approach that concerns us. New tolls could divert vehicles onto roads that are not designed safely to handle increased freight traffic. If Congress wants to pursue tolling, we would encourage it for new highway capacity, where toll lanes are optional.

So, in our view, sufficient capacity, seamless connectivity, and adequate funding should be important goals of the next highway bill.

Finally, it's worth remembering that 95 percent of the world's consumers are outside the American borders. The more we can do

to sell to them, the stronger our economy will be. That's why UPS supports negotiations on the Trans-Pacific Partnership, the Trade and International Services Agreement, and the Transatlantic Trade and Investment Partnership. Congress should also address the barriers that freight faces at and behind the border, with particular focus on Customs modernization.

In closing, we believe this subcommittee has a unique opportunity to improve freight capacity, connectivity, and funding. And we look forward to working with you throughout this legislative process.

[The prepared statement of Mr. Connelly follows:]

PREPARED STATEMENT OF MATT CONNELLY, VICE PRESIDENT, TRANSPORTATION, UPS

Chairman Warner, Ranking Member Blunt, and members of the Subcommittee, thank you for the opportunity to testify. At UPS, we deliver using every mode of transportation, so we can offer a broad perspective on ways to improve and fund America's transportation infrastructure.

UPS Operates in Every Transportation Mode

Each day at UPS, we deliver 16.3 million packages to 8.8 million customers. We serve every address in North America, and we operate in more than 220 countries and territories. It is estimated that, at any given time, the economic value of the goods and services moving in the UPS supply chain equates to 6 percent of our country's Gross Domestic Product, and 2 percent of global GDP. Our delivery fleet includes more than 96,000 commercial vehicles, which travelled more than 2.3 Billion miles on American roads and highways last year. We operate one of the largest airlines in the world with more than 560 owned and leased aircraft. Every year, we move 500,000 TEUs (containers) via UPS Ocean Freight Services. And, we are one of the largest customers of America's freight railroads, moving 3,000 trailers and containers by intermodal rail every day. With that kind of volume and the breadth of our multi-modal network, finding ways to eliminate bottlenecks is essential for us.

The Costs of Congestion

Congestion and inefficiency impose real costs on our company, our customers, and America's competitiveness. For example, if every UPS delivery vehicle is delayed just 5 minutes each day, it would cost UPS an additional $105 million in operating costs annually.

The Texas Transportation Institute found that congestion cost the U.S. economy $121 billion in 2011. In today's just-in-time manufacturing environment, delays in the flow of inputs and finished products make American companies less competitive and eventually force consumers to pay higher prices. Until our infrastructure is modernized, America's economy will fall short of its full potential.

That's why UPS supports a strong Federal role in transportation policy to ensure coordination and national focus. For example, MAP–21 included a "focus on freight," and we encourage a greater commitment to that idea in the next Surface Transportation Bill, along with a larger investment in projects of national and regional significance.

21st Century Transportation Infrastructure

Overall, what does 21st Century infrastructure look like? It provides sufficient capacity, runs seamlessly across modes, and is adequately funded today and into the future.

1. Sufficient Capacity

It starts with having *sufficient capacity* to meet the needs of all users. According to the American Trucking Associations, domestic freight demand will double by 2050, and truck freight demand will increase by 25 percent in just the next 12 years. America's capacity must keep pace with the rising demand.

2. Seamless Connections

Second, a modern infrastructure includes *seamless connections* between modes. Over the years, America's transportation system has been built mode-by-mode in silos. It's a patchwork. What we need is a network—a seamless system where freight can move between modes by the most efficient and economical path. At UPS,

we shift packages between trucks, rail, seaports and airports to find the most efficient, economical, and environmentally friendly route. When those intermodal connections are backed up, it hurts our customers and our country's productivity, so improving the connections between modes is critical.

3. Adequate Funding

And finally, our transportation infrastructure must be *adequately funded.* At UPS, we believe every funding option should be examined. Specifically, we believe that existing user fees should be increased, and new user fees should be considered as long as they are dedicated solely to transportation.

For example, we favor increasing the Federal fuel tax, indexing it to inflation, and dedicating the revenue exclusively to the Highway Trust Fund. Not many companies will stand up and say, "Tax us *more* for the transportation infrastructure we rely on." But that's exactly what UPS is saying—as long as the funding is not diverted to other uses. We want to be part of the solution, and we're willing to do our part.

Further, we believe a tax on "Vehicles Mile Traveled" (VMT) should be considered.

This Subcommittee is studying an Infrastructure Financing Authority, an idea we are open to exploring. So far, we have withheld judgment because, as always, the devil is in the details. We would look for dedicated funding to improve the flow of goods, such as projects that address highway infrastructure, freight rail fluidity, air traffic management, seaport connectivity, and related challenges.

Some have suggested adding tolls on interstate highways. It's an approach that concerns us. New tolls could divert vehicles onto roads that are not designed to safely handle increased freight traffic. If Congress wants to pursue tolling, we would encourage it for new highway capacity, where the toll lanes are optional.

So, in our view, sufficient capacity, seamless connectivity and adequate funding should be important goals of the next highway bill.

Strengthening America's Global Competitiveness

Finally, it's worth remembering that 95 percent of the world's consumers are outside America's borders. The more we can do to sell to them, the stronger our economy will be. That's why UPS supports negotiations on the: Trans-Pacific Partnership (T.P.P.), the Trade and International Services Agreement (T.I.S.A.), and the Transatlantic Trade and Investment Partnership (TTIP). Congress should also address the barriers that freight faces "at and behind the border," with particular focus on customs modernization.

In closing, we believe the Subcommittee has a unique opportunity to improve freight capacity, connectivity and funding, and we look forward to working with you throughout the legislative process.

Senator WARNER. Thank you, Mr. Connelly.

Mr. Basso?

STATEMENT OF PETER J. BASSO, PRINCIPAL, PETER J. BASSO AND ASSOCIATES, LLC, TRANSPORTATION FINANCE CONSULTANTS

Mr. BASSO. Thank you, Mr. Chairman and members of the Committee, for holding this important hearing.

As we approach the need to reauthorize surface transportation programs and, as important, to address the broad ways that funding and financing of infrastructure can be enhanced, new legislation to enhance, particularly, the financing component must be considered.

As has been well documented, there is a huge gap between infrastructure investment needs and the funding that's available. The American Society of Civil Engineers documented that 1 trillion is needed to meet needs, over the next 5 years, just to address current conditions; and, in surface transportation sector, we are investing only about 40 percent of what is needed at all levels of government.

In addition, as you mentioned, the Highway Trust Fund, the main Federal funding source, according to the Congressional Budget Office, according to the Congressional Budget Office, will, in fact,

fall very short of having sufficient money in Fiscal Year 2015 to meet obligations. And, in reality, the $40 billion highway program would be reduced to a $200 million program, or about a 98-percent reduction.

Let me turn to financing for a minute. Given that backdrop, one of the areas we have evolved over the past 15 years is financing. This method is different funding, in that it allows, through techniques such as GARVEE bonds, the TIFIA program, State infrastructure banks, Build America bonds, states to finance projects, thus moving forward much more quickly, and thus, providing them with needed infrastructure and savings of inflationary costs. All of these programs have made a contribution to expanding infrastructure investment. They need to be continued, and I'll discuss some additional tools that need to be added.

Also, we've experienced the growth of public-private partnerships, which brings private capital to the table and shares the project risk. In my written testimony, I provide some examples of such projects. However, it is clear that the private sector has much more in resources and, with the right vehicles, could make a larger contribution to the Nation's infrastructure needs.

An important point to mention is that most of these approaches require a revenue stream, since effectively, the debt must be repaid. Also, we need to consider how to make such programs work in rural America. I certainly believe that can be done relatively easily.

We're at a point where we need to consider the next step. A legislative approach, such as the BUILD Act proposal, would create a Federal corporation to advance loans, loan guarantees, and other forms of credit support. As I understand it, after the initial capitalization, the corporation would be self-sustaining and would also be open to such support for infrastructure.

And I'd add one point. For the last 8 years, I've been trying to get something like this enacted, and this is a wonderful time to take that up.

This new approach clearly would attract private capital and stimulate further growth of public-private partnerships.

So, let me conclude. At this critical time, we need to understand the differences between direct funding and financing, how they can work together to begin to address this massive infrastructure investment gap, and really fund and finance both.

Thank you.

[The prepared statement of Mr. Basso follows:]

PREPARED STATEMENT OF PETER J. BASSO, PRINCIPAL, PETER J. BASSO AND ASSOCIATES, LLC, TRANSPORTATION FINANCE CONSULTANTS

Mr. Chairman, I am Peter J. "Jack" Basso, Principal of Peter J. Basso and Associates, LLC and consultant to Parsons Brinkerhoff. I also serve on the advisory board of Meridiam Infrastructure North America. and as a Board Member of the Maryland Transportation Authority. I am pleased to be here today to discuss the critical need for infrastructure investment and ways that increased investment levels might be achieved.

The Federal Government is a key player in partnership with the State and local governments and the private sector. There is much to be done and achieving enhanced investment in the broad field of infrastructure can enhance America's international competitive position.

In my testimony I will discuss:

- the gap between needs for investment and the level of investment by all parties,
- provide information on the evolution of financing approaches that compliment traditional funding approaches,
- discuss new innovative financing approaches, *e.g.,* the advancement of proposals that would create an independent government corporation to enhance and expand financing to the broad infrastructure needs of the nation,
- provide information on how such innovations might be seen by both public and private partners in a way that would expand infrastructure investment

Current Transportation Funding at All Levels of Government Versus Transportation Investestment Needs

Currently all levels of government (Federal, state and local) invest an estimated $90 billion annually in surface transportation infrastructure.[1] The National Transportation Policy and Revenue Study Commission estimated that the needs at all levels of government to be an average of $225 billion annually. Thus the investment level is about forty percent of needs. This underinvest has been documented in various studies for at least the past twenty years.

Historically, the source of this investment has been predominately taxes and "user fees" complimented beginning in 1993 with the development of Federal credit programs for surface transportation. Such programs existed prior to that time for water and sewer programs and a few other Federal infrastructure programs.

The Current Crisis in Surface Transportaion Infrastructure Investemnt

While the Highway Trust Fund has served as the backbone of Federal surface transportation programs since 1956, it is now expected to reach a shortfall situation where virtually all new obligations will be eliminated in FY 2015. According to the Congressional Budget Office, this is due to the structural deficit between receipts and outlays which averages around $15 billion and will continue to increase over time.

If no new revenues are identified for the Highway Trust Fund, highway obligations are expected to be reduced by almost 100 percent from $40 billion in FY 2014 to $0.2 billion the following year. Transit obligations are expected to also experience a significant funding reduction.

The chart that follows graphically presents the impact of these reductions:

The Growing Federal Role for Surface Transportation Finance: 1990S to Today

In 1993 the Federal Government (Federal Highway Administration) began an effort to introduce credit tools into the system using Title 23 Test and Evaluation au-

[1] Source: The National Transportation Policy and Revenue Study Commission, 2008.

thority to solicit projects that might be developed using credit and project acceleration tools. States submitted multiple proposals and many were used to form the basis for financing as a departure from traditional revenue based funding.

In 1995 Congressional authority was sought using the Credit Reform Act of 1990 to make $400 million direct loan to contribute to the building of the Alameda Railroad Corridor in California. The key was the $400 million became the final piece of a $2 billion project and scored on the Federal budget not at $400 million but rather $50 million in appropriations. The loan was paid by tolls from the users of the corridor.

In that same period the Federal Government began authorizing states to issue Grant Anticipation Revenue Vehicles (GARVEE bonds) which are to be paid from future Federal apportionments from the HTF. Some $16.2 billion of bonds have been issued by twenty six states, the District of Columbia and Puerto Rico through, 2012.[2] The National Highway System Designation Act codified this program in 1995.

Other the credit concepts: in 1996 and 1997 the Federal Government appropriated funds to seed the development of State Infrastructure Banks and multiple states acted to create these banks. Many of these banks continue to operate today.

With the passage of TEA–21 the TIFIA program was created to provide, a portion of capital for loans, loan guarantees and standby lines of credit for transportation programs. The program was reauthorized most recently in MAP–21 with a tenfold increase in credit subsidy funding ($1.75 billion) with a leverage factor of 10 to 1 to the subsidy.

The Build America Bonds program enacted in the economic stimulus legislation further enhanced the advancement of credit financed projects.

It is important to keep in mind that tools like TIFIA loans that needs to be paid back over time are not like traditional grant dollars (e.g., Federal-aid Highway Program, Federal transit formula program, etc.). They fall in the realm of financing vehicles like bonding, which are used to leverage transportation funding and allow transportation agencies to raise the high upfront costs needed to build projects, and expedite the implementation of transportation improvements. As such, in order to utilize these financing tools, funding sources such as taxes, fees, and user charges—the very same revenues that are in short supply—must be pledged for repayment over decades.

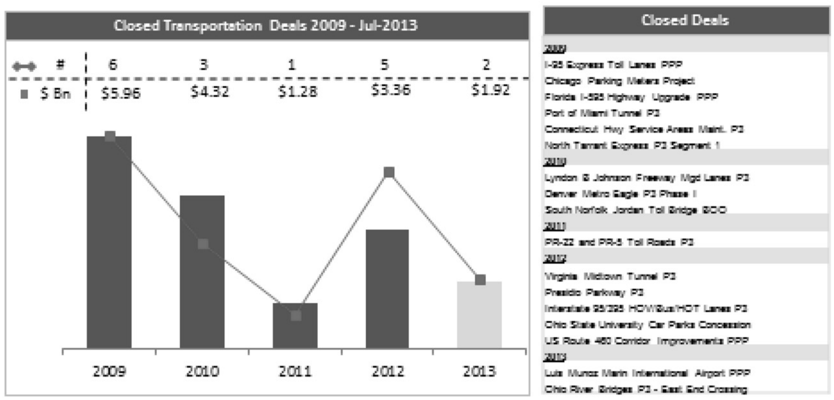
Public/Private Partnerships

A major development complementing the aforementioned financing programs has been the development of public-private partnerships (PPP) around the country. Early involvement of the private sector can bring creativity, efficiency, and capital to address complex transportation problems facing State and local governments. As project delivery and financing approaches, PPPs do not serve as a funding source; rather, private investment must be repaid with general revenue (taxes) or project-specific revenue (tolls). Public sector interest in PPPs has continued to increase in the recent years, as thirty three states now have adopted enabling legislation to permit its use.

Below are a series of examples of projects at have come about through the use of PPPs.

[2] Source: U.S. Federal Highway Administration data.

Transportation P3 Market Activity



It is clear from the data that P3s are a growing segment of the overall investment pool.

A Next Step Advancing Concepts Such as the Build Legislative Proposal

Several legislative proposals have been discussed in Congress and by the Administration to create new and enhanced financing vehicles. They include:

- Tax Credit Bond programs known as TRIP—Senators Wyden and Hoeven
- America Fast Forward Bonds—The Obama Administration
- The proposed Bridge Act—Senator Warner and others (Under development not yet introduced)

The goal of all of these financing tools are to expand investment in all forms of infrastructure highways, transit, water, power, selected energy programs rail and airports

Focusing on the BRIDGE concept it would create an Infrastructure Financing Authority to make loans, loan guarantees and lines of credit. As I understand it would follow the successful Export-Import Bank model. It would ultimately become fiscally self-sustaining. It would have broad authority to fund through credit instruments a vast array of infrastructure projects.

One of the key matters to address is the needs of rural America. Therefore as the legislation is drafted I urge that special consideration be given to those communities and provide for projects they can finance.

How Expanded Financing Options May Be Viewed By Public Entities

Many states are moving to increase investment in particular transportation infrastructure by increasing the funding. A discussion follows of states that have moved to increase revenue. Almost every state has in some form studies or enactments of revenue measures that will lead to increased state investment.

Many states have also adopted various forms of P3 legislation and are looking to enhance their financing to leverage revenues to expand project activity.

The chart below shows the increasing activity in the states to adopt legislation to incorporate financing P3 options.

States with PPP Enabling Legislation as of Sept. 7, 2011

Conclusions

America is at a crossroad. We have fallen from third in the world in infrastructure investment to 25th. Our investment level which now totals around 2.3 percent of GDP is outranked by twenty-four other countries including notably China.

Federal tax rates to sustain the Federal Highway Trust Fund have not been increased in twenty years leading diminished real investment by as much as 50 percent due to inflation.

Funding is critical to address the needs but financing through innovative tools such as TIFIA, the introduction of budget infrastructure bank proposals and state actions to engage in P3s as well as private sector access to larger pools of capital is an essential ingredient to making significant progress in re ally expanding all areas of infrastructure *investment.*

Senator WARNER. Thank you, Mr. Basso.

Mr. Dove?

STATEMENT OF ROBERT DOVE, MANAGING DIRECTOR, THE CARLYLE GROUP

Mr. DOVE. Mr. Chairman, Senator Blunt, and other members of the Committee, thank you for the opportunity to testify. I commend you and this committee for holding a hearing on such an important issue.

My name is Robert Dove, and I am a Managing Director of The Carlyle Group. The Carlyle Group is a global alternative asset manager of approximately $180 billion in assets under management. I manage The Carlyle Group's infrastructure fund, referred to as Carlyle Infrastructure Partners. Carlyle Infrastructure Partners is a $1.2 billion fund that was raised specifically to invest in transportation and water infrastructure projects in the United States.

Like most Carlyle funds, the Carlyle Infrastructure Partner Fund was raised primarily with investments from large pools of capital. These include State pension funds, private pension funds, insurance companies, and family offices. I am here today to highlight the benefits of private capital in infrastructure finance and to illustrate how the Federal Government can facilitate access to private capital that is available and poised to improve our nation's ailing infrastructure.

More and more pension funds are recognizing that infrastructure, as an asset class, is an important part of their asset alloca-

tion. Internationally, including Canada, pension funds allocate as much as 15 percent of their total assets to infrastructure investments. The allocation in the United States are not as prevalent, but are growing. For example, groups like CalPERS, the California State Retirement Fund, have grown its allocation to infrastructure over the past 5 years. Pension funds are growing their allocation because they view infrastructure investments as long-term investments and less volatile than other forms of investment. They also recognize that the risk of inflation can, in some ways, be mitigated, because the infrastructure concessions often include a link to consumer price indexes. With these recognitions, I expect that infrastructure investment allocations will continue to grow over the coming years.

I would like to highlight one particular investment that my colleague and friend Norm Mineta mentioned earlier that our fund has made. In 2010, we reached agreement with the state of Connecticut to enter into a partnership—and I emphasize the word "partnership"—to renovate and, in some cases, rebuild the 23 highway rest stop areas in the state. This is a good example of innovative financing and the creativity that is possible in a public-private partnership. Carlyle is investing approximately $130 million in rebuilding and renovating the highway rest areas over the first 5 years of our concession. These investments will create approximately 375 additional jobs. And, in total, the state is expected to see nearly $500 million in economic benefit from the redevelopment effort. The project is a win-win for the state and also the taxpayers and investors. The state and the taxpayers get to shift upfront costs and construction risks to the private sector. These risks include potential overruns of costs, missed deadlines, or project delivery dates. We are contractually bound to complete the rebuild and renovation within the first 5 years of the concession. Any cost overruns are ours, and not the state's. In the meantime, the state has preserved its bonding capability for other projects.

In return, Carlyle is free to develop the rest stops in an entrepreneurial manner to maximize consumer appeal. We've contracted with popular retail outlets in these centers like Dunkin' Donuts and Subway, and there are spacious and airy eating areas, as well as free Internet for travelers. As a result, we are seeing an increase in customer flow, from delivering better, more desirable services.

An important part of our contract is the partnership element. We have also agreed to share with the state our revenues above certain predetermined thresholds. Under this partnership, the state benefits financially from our success. We believe alignment with different stakeholders is an important consideration in creating public-private partnerships.

If the Federal Government were to set up an infrastructure financing authority, local infrastructure investment like this would increase. Bonding authorities would be reserved, and risk would be moved to the private sector. We need to face the reality that both Federal and local governments are operating under ever-growing budget constraints. A Federal financing authority is a way to tap into innovative financing and renew infrastructure investment.

In my view, the infrastructure financing authority should operate in addition to current Federal investment, not instead of current

Federal investment. Our goal should be to expand the pool of overall capital, not replace the Highway Trust Fund.

Mr. Chairman, although I have lived in the United States for over 30 years, you can tell from my accent that I was not born in the United States. Being from the United Kingdom, I have had the opportunity to directly observe a working infrastructure financing authority in Europe, and I believe that we can learn a lot from this experience.

The European Investment Bank, known commonly as the EIB, provides loans, makes guarantees that are expected to be repaid or extinguished. The EIB lends money for long periods, sometimes as much as 40 years, at a low interest rate, and, in doing so, provides a level of capital that allows other participants, both commercial banks, the private sector equity investors, and others, to participate in a project that otherwise would struggle to obtain financing.

Importantly, the lending of the EIB is driven by government, but the actual credit decisions on specific loans, guarantee proposals presented to the bank are determined by a professional staff operating independently within the bank. Like the EIB, any U.S. infrastructure financing authority should be independent to determine the creditworthiness of proposed projects. Congress should give direction on what infrastructure should be built, be it roads, bridges, rail, water treatment facilities, et cetera. But, the financing authority should be free to make independent financing determinations based on a thorough case-by-case review of the proposed budget.

It is my view that the stark reality here is that, if we don't find a way to stimulate private financing, our nation's infrastructure will continue to decline. The growing interest by pension funds and other pools of capital that are looking to invest in infrastructure will go where infrastructure opportunities are, whether it be an airport in the U.K., a port in Latin America, or a road in Australia.

Mr. Chairman, you are at an important crossroads in this committee, and I applaud you for exploring an infrastructure financing authority. At a minimum, you are changing the debate from how much to fund infrastructure to how to locate more funding opportunities. This is an important shift, and I applaud your work.

Thank you for your time today, and I will be happy to answer questions in due course.

[The prepared statement of Mr. Dove follows:]

PREPARED STATEMENT OF ROBERT DOVE, MANAGING DIRECTOR, THE CARLYLE GROUP

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More and more pension funds are recognizing that infrastructure, as an asset class, is an important part of their asset allocation. Internationally, including in Canada, pension funds allocate as much as 15 percent of their assets to infrastructure investments. The allocations in the United Sates are not as prevalent, but are growing. For example groups like CalPERs, the California State retirement Fund, have grown its asset allocation to infrastructure over the past 5 years. Pension funds are growing their allocation because they view infrastructure investments as long-term investments, and less volatile than other forms of investment. They also recognize that the risk of inflation can be mitigated because the infrastructure concessions often include a link to the consumer price index. For these recognitions, I expect that infrastructure investment allocations will continue to grow.

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This project is a win for the state, a win for the taxpayer, and a win for the investor. The state and the taxpayer get to shift upfront costs and risks to the private sector. These risks include potential cost over-runs, missed deadlines, or missed project delivery dates. We are contractually bound to complete the rebuilds and renovation within the first 5 years of the concessions. Any cost over-runs are ours and not the States. In the meantime the state has preserved its bonding capabilities for other projects.

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If the Federal Government were to set up an infrastructure financing authority, local infrastructure investment like this would increase, bonding authority would be reserved and risk would be moved to the private sector.

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It is my view that the stark reality here is that if we don't find a way to stimulate private financing, our Nation's infrastructure will continue to decline. The growing interest by pension funds and other pools of capital that are looking to invest in infrastructure will go where the investment opportunities are whether it be airports in the UK or ports in Latin America or roads in Australia.

Mr. Chairman, you are at an important crossroads in this committee and I applaud you for exploring an infrastructure financing authority. At a minimum, you are changing the debate from "how much to fund" infrastructure to "how to create more funding". This is an important shift and I applaud your work.

Thank you for your time today and I will be happy to answer any questions.

Senator WARNER. Thank you, Mr. Dove.

Mr. Offutt?

STATEMENT OF J. PERRY OFFUTT, MANAGING DIRECTOR, MORGAN STANLEY & CO. LLC

Mr. OFFUTT. Mr. Chairman, Senator Blunt, and members of the Subcommittee, it's my pleasure to be here this afternoon.

My group at Morgan Stanley works with both public- and private-sector clients seeking opportunity for private capital to invest in U.S. infrastructure projects. For example, I'm currently advising a qualified bidding consortium on the potential reconstruction and operation of LaGuardia Airport's central terminal. As a financial advisor focused on public-private partnerships, P3s, I appreciate the opportunity to share my perspective on how Federal funds can be used to partner with private capital to increase overall investment in U.S. infrastructure.

While P3 processes can often be very complex and time-consuming, I believe that a well-constructed P3 transaction can truly be a win-win-win for a government entity, the private sector, and the broader community.

Over $250 billion of private equity capital has been raised globally to invest in infrastructure projects, of which at least 75 billion of equity capital has not been invested. This capital is attracted to these projects, given the potential to achieve long-term, stable cashflows and attractive risk-adjusted returns. However, since much of this capital can also evaluate opportunities outside the United States, it is important to demonstrate that a U.S. project is commercially and financially viable, as well as has political support, in order to attract interest from prospective private investors.

Assuming equity investors can access competitive debt financing, they can add a great deal of value to the public partner. One, they can assume much of the construction and operating risks associated with a project. Two, they can build projects more quickly and at a lower cost. Three, they can drive efficiencies, over time, by introducing technology solutions. And four, they can develop incremental revenue sources by developing additional services.

It is also important to recognize that, because investor return expectations and the desire for stable cash flows, that some projects do not lend themselves to P3s on a standalone basis. For example, the construction and operation of a typical transit project doesn't always generate sufficient fare revenues to cover its expenditures. In these cases, some form of availability payment from the government entity is required for the private sector, either debt or equity investors, to earn this adequate return I mentioned. Therefore, availability payments similar to passthrough tolls are often used to pay the private entity to compensate them for the responsibility to design, construct, operate, and maintain an infrastructure asset for an agreed-upon time.

While many states and local governments are already pursuing initiatives to address the U.S. infrastructure crisis, such as implementing P3 legislation, the Federal Government can also play a critical complementary role. Given limited additional debt capacity at State and local levels, due to significant existing debt and large pension funds liabilities, the Federal Government's presence is critical to support some of these essential projects. An infrastructure finance authority could be a key part of such a plan by having an independent organization that can help facilitate and financially support projects of national and/or regional significance that wouldn't otherwise be completed.

Of course, this is not to say that the tax-exempt market and existing programs, such as TIFIA, are not effective sources of financing for many projects, but, Mr. Chairman, as you mentioned earlier, there is no single answer to solve the national infrastructure needs. And so, having as many tools in the toolbox to address this critical issue is important.

Thank you very much for the opportunity to testify this afternoon on this important topic, and I'd be glad to answer any questions the Committee has.

[The prepared statement of Mr. Offutt follows:]

PREPARED STATEMENT OF J. PERRY OFFUTT, MANAGING DIRECTOR, MORGAN STANLEY & CO. LLC

Good afternoon, Mr. Chairman, Senator Blunt and members of the Subcommittee. It is my pleasure to be here this afternoon.

My name is Perry Offutt. I am a Managing Director in the Investment Banking Division of Morgan Stanley and am the Head of Infrastructure Investment Banking for the Americas. My group focuses on innovative transaction structures to utilize private capital to invest in infrastructure projects. Many of the projects on which I work are structured as public-private partnerships (defined below). I work with both public and private sector clients.

For example, I am advising or recently advised on the following transactions:

1. Meridiam/Skanska/Vantage on their potential bid for the LaGuardia Airport Central Terminal Building Replacement Project (RFP issued August 2013, ongoing)
2. The Ohio State University on its $483 million parking concession (public-private partnership closed in 2012)
3. Potentially privatizing the sewer system in Nassau County, New York to realize operating efficiencies and improve system integrity (studied in 2011 and 2012)
4. OHL Concesiones/Morgan Stanley Infrastructure Partners on their bid for the concession of Puerto Rico's PR–22 and PR–5 toll roads (public-private partnership bid submitted in May 2011)
5. City of Indianapolis on concession of City metered parking system (public-private partnership closed in 2010)
6. Citizens Energy Group on $1.9 billion acquisition of Indianapolis water and wastewater system (sale closed in 2011)
7. Morgan Stanley Infrastructure Partners on its acquisition of NStar's district energy operations (sale closed in 2010)

As a financial advisor focused on public-private partnerships, I appreciate the opportunity to share my perspective on how Federal funds can be used to partner with private investment to supplement current infrastructure funding and increase overall investment into U.S. infrastructure projects.

Public-Private Partnerships

A Public-Private Partnership ("P3") involves a long-term lease (not a sale) of municipal assets (the "Concession"). The specific terms regarding how the asset is operated and maintained are included in a contract between the public agency/govern-

ment and a private sector entity (the "Concession Agreement"). The government retains ownership with a right to reclaim the assets if the private operator does not meet certain standards. Under such an arrangement, some degree of risk and responsibility is transferred from the public to the private entity.

Due to the many safety and security concerns associated with operating core infrastructure assets, it is essential that all potential private partners undergo an extensive evaluation of their qualifications. Such an evaluation is typical in P3 processes. Traditionally, the procuring government entity will issue a Request for Qualifications ("RFQ") that requires private operators to submit a response listing their qualifications in the areas of design, construction, operations and maintenance, as well as describing their ability to finance construction and improvements as necessary. In order to be considered as a bidder for a P3, a private party needs to pass all criteria in this qualifications phase. Consequently, the government can screen which private bidding groups are able to submit a final bid for a P3 project.

While these processes can often be very complex and time consuming, we at Morgan Stanley believe that a well-constructed P3 transaction can truly be a win-win-win for a government entity, the private sector and the end users.

Private Capital Available for P3s

Morgan Stanley estimates that over $250 billion of private capital has been raised globally to invest in infrastructure projects (of which over $75 billion has not been invested). This capital is attracted to these investment opportunities given the potential to achieve long-term stable cash flows and attractive risk-adjusted returns for the project. Many of these investors (typically pension or infrastructure funds) have the ability to invest in various geographies around the world and across various infrastructure assets (*e.g.,* transportation, regulated utilities, contracted power/energy and telecommunications). In order to mitigate potential macro-economic risks, many investors also tend to focus on jurisdictions with stable economic and regulatory environments so the U.S. is an obvious area of focus.

Attracting the private sector as a partner can: (i) leverage public funds, (ii) deliver a superior outcome for the project and (iii) shift risk (*e.g.,* construction and operations) to the private sector. The private sector can often build a project more quickly and at a lower cost; drive efficiencies over time by introducing technology solutions; and develop incremental revenue sources by delivering additional services.

Given that private capital also frequently evaluates opportunities outside U.S. infrastructure, it is important to demonstrate that a U.S. project is commercially/financially viable and has political support in order to attract interest from prospective private investors. However, it is important to recognize that because of investors' return expectations and desire for stable cash flows, some projects *do not* lend themselves to P3s on a standalone basis.

For example, the construction and operation of a typical transit project does not generate sufficient fare revenues to cover ongoing expenditures. In these cases, some form of "availability payment" from the government entity is required for the private investors (debt and equity) to earn an adequate risk-adjusted return. As part of the Concession Agreement, availability payments (similar to pass-through tolls) are agreed to be paid (often subject to annual appropriation) to the private entity as compensation for its responsibility to design, construct, operate and/or maintain a roadway for an agreed upon time. These payments are based particular milestones or facility performance standards.

The following is an example of a P3 transaction that utilized an availability payment structure:

> In October 2009, the Florida Department of Transportation ("FDOT"), in conjunction with the City of Miami and U.S. DOT, reached financial close for the Port of Miami Tunnel and Access Improvement Project. This P3 project involves the construction of a tunnel under the Port of Miami at an estimated project cost of approximately $900 million (financed with public and private capital). The winning bidder (Meridiam and Bouygues) proposed providing equity upfront plus helped arrange $342 million of senior financing with project finance banks. Other funding was provided by a TIFIA loan. In addition, FDOT pledged to make "milestone" payments throughout the construction process, followed by availability payments following completion. These payments from FDOT helped provide the winning bidder with comfort that, despite uncertainty around the total traffic in the tunnel, the government was willing to serve as a "buffer" for future traffic risks. Depending on the specific projected cash flows of the project, this may or may not be needed.

In the above example, the availability payments from FDOT de-risked the project enough for the private sector to secure both equity and debt financing for this im-

portant infrastructure project. In addition, this project is an example of how Federal capital can be leveraged (only 1/3 of the project costs were financed with TIFIA financing).

Another challenge facing some U.S. P3s is convincing the private sector that there is sufficient political will to complete the P3. Given the high costs to reach a binding bid (*i.e.,* significant due diligence costs), private capital focuses early in the process on the regulatory/political approval process. If there is not perceived to be adequate political support or a clear path to gaining required approvals, many private investors will decide not to prepare a bid. Consequently, any additional Federal support (both monetary and political) would be very helpful to minimize this risk.

Current Need for Significant Infrastructure Investment

Earlier this year, the American Society of Civil Engineers (ASCE) reported that $2.2 trillion would be needed over the next five years to raise America's infrastructure from its current "poor" rating to a "good" rating, which is required to ensure reliable transportation, energy and water/wastewater systems. For example, the Federal Highway Administration (FHWA) estimates that to eliminate the Nation's bridge deficient backlog by 2028, we would need to invest $20.5 billion annually, while only $12.8 billion is being spent currently. Such projected shortfalls are quite troubling. No one wants another bridge to collapse, as did the I–35W Mississippi River Bridge.

When you compare the percentage of GDP that the U.S. is spending on infrastructure relative to emerging markets, the ASCE's conclusion is not surprising. For example, between 2000 and 2006, the total public spending on infrastructure in the U.S. was less than 2.5 percent of GDP versus China, which spent almost 10 percent.

Unfortunately, there currently is no specific plan in place to address the magnitude or the immediate urgency of this problem. Leadership from the Federal Government could help attract significantly more private capital to a greater number of key infrastructure projects.

Given limited additional debt capacity at state and local levels due to significant existing debt and large pension liabilities, the Federal Government's presence is critical to support some of these essential projects. However, it does depend on the location and complexity of the project; the tax-exempt market and existing programs (*e.g.,* TIFIA) are effective funding sources for many projects.

Ideas to Consider

Various types of infrastructure projects need funding, ranging from improvements of high cash generating "brownfield" projects (*i.e.,* existing operating assets) to investments in social services that are not focused on profitability (*e.g.,* public transit). In order for the Nation to finance such a wide range of projects, sponsors need to have access to a large variety of public and/or private financing alternatives. Therefore, at Morgan Stanley we see the benefits of programs that provide grants, low-cost loans (*e.g.,* TIFIA and RRIF loans) and loan guarantees. In many cases, public capital from Federal, state and/or local sources can be leveraged with additional capital from the private sector. This can be done while also promoting a healthy tax-exempt bond market.

While many states and local governments are already pursuing initiatives to address the U.S. infrastructure crisis such as implementing P3 legislation, the Federal Government can also play a critical complimentary role. Specifically, the Federal Government should develop a long-term plan for development and maintenance of the country's infrastructure as has been done successfully by other countries. An "infrastructure finance authority" would be a key part of such a plan. This independent organization could help facilitate and financially support (via loans and loan guarantees) projects of national and/or regional significance that would otherwise not be completed.

Thank you very much for the opportunity to testify here this afternoon on this very important topic. I would be glad to answer any questions that you may have.

Senator WARNER. Well, I, again, want to thank the panel for very good testimony. And I'll be trying to make sure I adhere to the 5 minute limit so that all my colleagues get a chance.

I really think there are three or four reasons why this idea ought to be—get serious examination from my colleagues. You know, a lot of these projects—I think Mr. Offutt mentioned—are complex and have a variety of different sources coming—State, local, private capital—that all need to be mixed together, and that, oftentimes,

to make these projects viable, you need the ability of some long-term capital, as you mentioned, of 30- to 40-year term, that, candidly, without some public-related infrastructure financing ability, the private sector's not willing to lend at a competitive rate without that long-term capital.

Second—and I guess one of the things I want to reemphasize—is that any financing authority we'd be talking about would be independent. I think TIFIA and WIFIA and others are great initiatives, but the idea of being able to have the decisionmaking made by an independent body so that there is no hint of any kind of political interference is critical and would have to meet investment-grade criteria. And I—this would come to the question I want to pose for Mr. Basso and Mr.—maybe—and Secretary Mineta—about the question, of expertise.

And finally, obviously, when you had the backing of the Federal Government behind it, and one of the things in—Mr. Dove has mentioned it—every other—most every other industrial country in the world has one of these tools, when you're looking at, say, a port redevelopment, as you would in Virginia or Mississippi, you know, it is a tool that we ought to have in the toolbox.

So, maybe starting with Secretary Mineta and Mr. Basso, you know, you've both seen these—kind of, the way we segment financing in different buckets across the Federal Government at the State government. Do you think there would be value in having, at least from an expertise component, a—this financing authority, in addition to all of these other programs, to be able to have the kind of human capital that could go toe-to-toe with your colleagues on the panel?

Secretary Mineta and then——

Mr. MINETA. Mr. Chairman, there's no question that having the financial expertise is a necessity, in terms of putting the projects together. And that's something, I think, that we have lacked on the public-sector side. The process, I think, is really, how long should these concession agreements be for? And are there—in that, let's say, 50–75 year time period, are there windows of opportunities for reexamination of the project?

I think, in the case of the—like the Chicago skyway, where it's a 99 year project, Mayor Daley got the full 3.2 billion up front, and that precludes any future mayors from having any access to that. And I think that shortfall, or that opportunity, came about because, again, the public sector didn't have the expertise, in terms of the financing capability. And how would that be dealt with during the interim of that concession period?

And I would hope that, whatever mechanism is set up, that there would be these opportunities for adjustments to be made in the interim and that it's not locked in from the first year, to the exclusion of any further examination.

Senator WARNER. Mr. Basso?

Mr. BASSO. Mr. Chairman, let me cite an example. The state of Maryland, about 2 years ago, undertook a privatization public-private partnership in the Port of Baltimore. The expertise that was required to carry that out—I serve on the Maryland Transportation Authority Board, so I was involved in this project—was not in-house. We had to develop in-house capacities; more importantly,

bring in outside experts and private-sector experts to put these projects together. The end result of that was to take a situation where a major marine terminal had to be rebuilt. The state had nowhere near the resources, but Ports America did.

A deal was struck. That deal did three things. It, number one, expanded the Seagirt marine terminal to be able to deal with the Panamax ships coming up. And that was critical. Second, it produced $150 million for the tollroads system in Maryland to do, basically, system preservation, so forth. And, third, it took a situation, which could have put the Port of Baltimore out of business, basically, in that competition, and put them out in front.

So, it's critical—I'd say three things—the first is, it's critical to recognize, the Federal Government does not have the kind of expertise the private sector does in these. So, creating a system or a bank or something like that with that expertise is crucial. Second, joining the Federal, State, and local government and the private sector, bring all that expertise together, can produce a dramatically effective result. I've seen it in reality. And, third, clearly we need to do this—I mean, I had a lot of experience dealing with loan programs, and we knew what we didn't know. And therefore, we needed to acquire that expertise to really be a successful one.

Senator WARNER. My time's about up, and I would hope, Mr. Dove and Mr. Offutt, you could maybe just give me a very brief—because we have this hodgepodge of states who are going into this, or localities going into this, lacking some national entity that can combine this expertise, are we leaving a lot of pension fund and other private money that isn't able to look at these projects, because they don't have, for example, the backing of the full faith and credit of the United States? Short answers?

Mr. DOVE. Mr. Chairman, I would say that, as an investor, if I was dealing with a counterparty who was sophisticated, which is what an international investment—infrastructure financing authority would be, by definition, it would give me a lot of comfort. A lot of times, when we look at and we hear about projects, it's, "Do they have the political will to get it through? And can they actually deliver?"

Something which comes through an infrastructure financing authority, by definition, should have that stature and, therefore, would attract a lot more money. So, I think it's right.

Mr. OFFUTT. Yes. And that was actually the point I wanted to underscore, as well, is political will. And it's at the local level, you clearly need to have a champion at either the Governor's office or the DOT and so on—but, also be able to say, at the Federal level, that this is a project that has the support, and it is significant, from a regional or a national basis, is very important. Because, again, these investors can spend their money any way they want, in terms of when they look at opportunities around the globe, and political risk is one of the biggest areas that they focus on, initially.

Senator WARNER. Thank you.

Senator Blunt?

Senator BLUNT. Thank you, Chairman.

Mr. Basso, on the Port of Baltimore, was—obviously, there's a management concession involved in that? Is that how the outside company would be attracted to come in and become a partner?

Mr. BASSO. Senator Blunt, that's correct. There's a management incentive. Ports America will manage that particular phase of the port. And, second, what they were able to bring was close to a billion dollars in capital to make the kind of improvements, dredging, and expansion that needed to be made—again, with the state having—not having to take that on, on their balance sheet. So——

Senator BLUNT. Right.

Mr. BASSO.—yes.

Senator BLUNT. Right. And, as a public entity, how did you calculate what the proper management length of time the concession would be?

Mr. BASSO. The calculation, which was 30 years, was based on experiences around the world. And again, this is where I made the point, bringing in outside, independent expertise in the ports area gave us guidance. We didn't have that expertise, but we were able to, if you will, engage that expertise, and came to a satisfactory conclusion on what the appropriate time frame would be.

Senator BLUNT. And what would you think would be one or two of the biggest hurdles in getting the private sector involved in financing, improving, managing, whatever you need to do, from all of your experience at AASHTO and in Maryland?

Mr. BASSO. I think the biggest risk, first of all, is timeliness, being able to actually put a request for proposal together, execute it, and not have it become tied up in years of both litigation and delay. That's the number one point.

Second is a very cooperative spirit in government, a willingness to say, "We can adopt a can-do attitude in this. We're not going to, basically"—to put it bluntly—"bureaucrat the thing to death."

Senator BLUNT. Mr. Dove and Mr. Offutt, the same question, from each of you, which is, what do you look for, as an outside investor, in terms of what makes an investment an appealing one for you to make?

Mr. DOVE. Senator Blunt, the most paramount thing is the political will to get this done.

I talk about "partnership." I genuinely believe that, in any infrastructure investment, there are different stakeholders. So, you have the users, you have the political stakeholders, you have the environmental groups, and you have the—people like my investors—the pension fund. And not everybody is always aligned. But, if you can structure something where there's some sort of partnership—true partnership, either through revenue-sharing or through some form of concession, where, after a certain number of years, it's relooked at and maybe adjusted, things like that—those are the types of transactions which are going to be successful. Because, as Secretary Mineta said, you know, the ones where you get a large amount up front and, 99 years later, you get the road back, those have got to have some huge political risk down the road. As the owner of that, you're left with it in a very difficult political environment.

So, some form of sharing of the risk, sharing with the stakeholders, but, overall, it's the political will to get something done.

Senator BLUNT. Mr. Offutt?

Mr. OFFUTT. And just to add on to that. Assuming that the project has the political will, then it really does come down to the

financial analysis. And, from that perspective, the private sector is very open. If a concession agreement could be shorter, it's going to be less value up front, and therefore, might demand or might be more difficult to make some of those needed capital expenditures up front. So, trying to find a happy medium between the private and public sector, a lot of times just has to do with the math associated with figuring out, how do you maximize the value to the public sector without giving away too much of the potential upside? And I think we believe that the market really has evolved from the 99-year leases that happened in the early days of public-private partnerships to much shorter-based concession agreements, and ones much more focused on sharing elements of either profits or revenues.

Senator BLUNT. And then, in another kind of investment in some kind of financing authority, what if there is no real concession agreement, but this is just a pension making an investment through a financing authority in something that a local government's going to pay back? How's that a—it's a different decision. Is there still appeal there to a—to that—does that financing authority still have some appeal to the fund or the investor?

Mr. Dove?

Mr. DOVE. I think what the financing authority does is provide a layer of capital. So, in a capital structure, you have a layer of capital, which, as I suggested, if you look at the EIB as a model, is low-cost money for a very long period of time. That allows commercial banks, equity investors, and others to come in and add layers of capital to fund the project. If you don't have that long-term set of capital, it becomes more challenging. Not every project needs it, but a lot of the ones which are more difficult to analyze probably will need it.

Senator BLUNT. And one quick question, over on this end of the table, on—on the intermodal kinds of facilities that both UPS would be part of, and, obviously, Secretary, you were part of, what are some of the challenges there, from, you know, truck-to-rail or rail-to-port? Are—where are those facilities, in terms of where they need to be?

Go ahead, Mr. Connelly.

Mr. CONNELLY. Yes, thank you—thank you, Senator Blunt. From our point of view in the past, the strategy and the vision for each one of those products, whether it be an ocean port or whether it be an inland port or a rail terminal, were all done in isolation, and they weren't done collectively or holistically, or looked at from a regional point of view or a national point of view. So, UPS recommends a view of how to seamlessly connect those modes, not just on a long-term basis, but give the transportation community the ability to toggle back between modes in a much more seamless manner. That could be having infrastructure tying rail to ocean, rail to highway, so it's not as choppy as it sometimes can be if it's not planned in aggregate as a network versus a patchwork type of deal.

Senator BLUNT. Secretary?

Mr. MINETA. I was trying to think back on the kinds of projects, and I think the closest I can think of is really the Alameda Corridor, because of the congestion at the Port of Los Angeles, Port of

Long Beach, trying to get the rail out of there and then get them to a point further away from the congestion. And, I think, there we did deal with multiple modes, in terms of trying to deal with that.

But, I think, in the overall, it really depends on, can you physically congregate the intermodal intersection that's going to be efficient for each of the modes? And I think that becomes a very difficult one of trying to find, Where is each mode going to be satisfied?—that they're not all going to be able to economize on where it's going to be, but it gives them the maximum efficiency of the operation. And sometimes those efficiencies of operations get lost when they're trying to figure out where to do that, as Mr. Connelly said, on a seamless basis.

Senator BLUNT. Thank you.

Senator WARNER. Thank you, Senator Blunt.

Senator Klobuchar.

Senator KLOBUCHAR. Thank you very much, Mr. Chairman.

Mr. Offutt, investments in transportation, as you know, have—it's a percentage of GDP—have declined to its lowest level in 20 years. And I really appreciated the discussion you had with Senator Blunt about the public maximizing what the public can get out of it, but still creating those investments for private investment. Can you talk about how this kind of funding would lessen the demands on public-sector funding, and then why infrastructure, as an asset class, is appealing to investors?

Mr. OFFUTT. Sure. Senator, in the first part of the question, how do you end up leveraging a lot of the capital that the public sector can raise, either a typical tax-exempt financing or TIFIA loans, which is obviously quite popular for a lot of transportation, specifically road transactions? Really, it goes back to one of the points that Mr. Dove made. When you think about the different capital that needs to be raised, with the riskiest capital being the equity capital and, obviously, the least risky being potentially, the most senior, which could be the TIFIA loan, in some cases, these projects are very complicated, but if you structure it the right way, as a partnership, it does seem like, not only in terms of the operations of the asset, but really from a financing perspective, the private and public side should have a lot of money at risk with that specific project.

Senator KLOBUCHAR. You talked, in your testimony, about shifting the risk to the private sector.

Mr. OFFUTT. Yes.

Senator KLOBUCHAR. Can you talk about how that would work?

Mr. OFFUTT. Sure. The private sector definitely has capabilities that they feel very comfortable with. Let's say, for example, constructing a very complicated bridge or tunnel. The private sector does that all the time. Sometimes they do it through a contract, and other times they will put their own capital at risk. And in the public-private-partnership framework, they actually do that. So, that's one risk: the actual construction of a project. And then the operations are ones if it doesn't go well, then they could actually lose money, and therefore, they are at risk. And the public sector, therefore, has transferred that risk to the private sector.

Senator KLOBUCHAR. OK, thank you.

Mr. Mineta, I was just on the phone this morning with your old friend, former Congressman Oberstar, who is the Chair of the House committee. He's still working on transportation. Could you talk about the importance of making sure rural areas could be able to access funds in an infrastructure bank?

Mr. MINETA. In terms of the nature of the project, there probably should not—or there isn't that much difference between a project in an urban area and a rural area. I think, in terms of the size, it would probably be much different, and it would also be dependent on a mode.

And I was thinking of the—when you asked the question about northwest Arkansas. Here, they were without an airport in that area, and yet you had Tyson's, Arkansas Best Freight, Walmart—who else?—oh, and J.B. Hunt, the trucking company—all concentrated in that area. And so, the financing of that was really from the Department of Transportation, and there was a great deal of private financing that went into the Northwest Regional Airport.

And—but, again, the attractiveness—that really started out, first, on an Alliance-type approach. The Alliance Airport is really just for commercial aviation, or commercial projects. But, it eventually became a general aviation—not general aviation in small airplanes, but of all aircraft, whether it be freight or passenger. And that came about, I think, because, again, the attractiveness of the size of the project and the concentration of that business community that made it attractive.

Senator KLOBUCHAR. Very good.

Mr. MINETA. Are there many communities that can put that kind of package together? I'm not really sure.

Senator KLOBUCHAR. Thank you. Mr. Dove, I know that you worked at a package in Connecticut, something that you did, and it was an example of how the private sector can get involved in transportation.

I was just with the CEO of Burlington Northern, Matt Rose, on Friday with Congressman Oberstar. We did a big transportation forum in Minnesota. And I would ask about that project and how you think this worked. Because Rochester, right now, home of the Mayo Clinic, is working very hard to create a Zip Rail system, which would be in partnership with government.

Mr. DOVE. So, I think, again I can only emphasize that it's the partnership in—whether it's with a state or whether it's with a freight rail line, being able to partner with them in a way where there's a win-win for all the stakeholders is very important. And I just think that an international—sorry—an infrastructure financing authority has that ability to sort of bring people together, because everybody will be able to have their own needs taken care of through an independent organization which has got the structure and expertise.

Senator KLOBUCHAR. Well, and I will appreciate your help with some of our colleagues, because even trying to get—the industry in the barge area wants to pay higher fees to improve the locks and dams, and we've had some issues trying to get that through the House. And I think people are just going to have to start thinking of this differently, that it's not a—if that's a tax increase, I don't know what is, when the industry that uses the infrastructure

wants to pay a higher fee so that they can have better infrastructure. And that's how we have to start looking at this in a different model.

So, thank you.

Senator WARNER. Thank you, Senator Klobuchar.

So Senator Blumenthal doesn't think he's getting jumped in line, Senator Thune has been, actually, out in the waiting room, and, as the Ranking Member of the full committee——

Senator Thune.

STATEMENT OF HON. JOHN THUNE, U.S. SENATOR FROM SOUTH DAKOTA

Senator THUNE. Thank you, Chairman Warner and Ranking Member Blunt, for holding this subcommittee hearing. And I want to thank our witnesses for being here today, and for their testimony.

I'm a big advocate of maintaining our nation's infrastructure. When you come from a state like South Dakota, it's pretty essential that you have a good infrastructure system to deliver critical agricultural products and natural resources from their source to their markets. And it's probably, today's hearing, very timely, given the fact that the American Society of Civil Engineers' recent report gave our nation's infrastructure an overall grade of D-plus. And that's just something that I think all of us agree is unacceptable.

As I look at the needs that we have out there, and the fact that, in 2015, the Highway Trust Fund is going to have insufficient resources to meet our obligations, and it's going to take an additional $15 billion just to maintain current spending levels, plus inflation, it's pretty clear we've got a problem there with the Trust Fund, but it's also important that, when we think about these new, sort of, innovative infrastructure funding mechanisms, that we take into account the needs of the entire nation. And I think that has been touched upon today by some of my colleagues. But, it's important that rural states, like South Dakota, which have unique challenges, are also able to participate in those types of programs, and that these innovative financing mechanisms are not a replacement for, or substitute for, but additive to the important role the Federal Government has in ensuring that our nation's transportation network is maintained and improved.

So, I guess what I'm trying to say is, I just don't think money ought to be diverted from the Highway Trust Fund to help pay for some of these funding mechanisms, because it could undermine the very nature of the user finance structure that's been so important to our nation's overall transportation investments.

And I appreciate the discussion that you all have been having today. And again, I want to thank you, Mr. Chairman and Senator Blunt, for having the hearing.

I did want to ask, with regard to these new ideas and things that are out there—the Highway Trust Fund does provide a reliable base infrastructure funding to the states each year, something many of them count on for a majority of their overall construction budget. How do we ensure that an infrastructure financing authority is self-financing and doesn't divert funds that would otherwise be used to support the Highway Trust Fund? And I guess I would

open that up to anybody who would like to take a shot at that question.

Mr. BASSO. Mr. Chairman?

Senator Thune, thank you for that question. And I think the answer is by how you structure the organization and how it's, basically, segregated from the main flow of money.

There would be a need for an initial capitalization—I mean, clearly, from that—whether it's the Highway Trust Fund, the General Fund, or even through bonds issued to raise the funds. And I think that can be overcome and dealt with.

I think you—I think you're correct. Right now, when we're, basically, at zero, in terms of the support of the revenue, to do something else is not going to add much value to that. What I believe is—when you do two things. I think we need to address the direct revenue question. There are—a number of things can be done on that. And the second is, in getting these funds off the ground, and this kind of an infrastructure mechanism, it could be very helpful, not only to urban or big projects, but rural areas. I had a lot of time to contemplate this in the stimulus bill, when we tried to move, basically, an infrastructure bank proposal, and we made special allocations for the rural areas, to help make that more usable and attractive along the way.

Bottom line is, we need an overall growth in all areas of infrastructure investment. And to go forward the way we are is to really put us in an extremely drastic downturn in our competitive position in the world, is my belief. So——

Senator THUNE. Let me ask, if I could—and I'd like to direct this to Mr. Dove and/or Mr. Offutt—could you provide the Committee with some examples of infrastructure projects that have been funded through private investment, and explain, in particular, what made those projects right for that sort of investment?

Mr. DOVE. In my oral remarks, Senator, there was a discussion about a project in Connecticut, which I think is a good example, but I will also cite another example, which members of the Committee here may be familiar with, which is the Miami Ports Tunnel, where there was a need, basically, to take trucks off the surface streets between Interstate 95 and the port by the construction of a tunnel. And the private sector became involved in that, and has financed that, and they did it through a combination of different sources of revenue.

But, at the end of the day, the tunneling risk, basically, fell with the private sector and not with the public sector, which was a great benefit to the state of Florida. So, that's one example of it.

Mr. OFFUTT. Yes, the good news is, there are definitely examples in the United States. I think it's a growing number. We're still fairly small, relative to some other countries, like the U.K. and Australia, that have been quite busy at this before. But, you can think about one, recently, in the state of Indiana, where a bridge between Indiana and Kentucky was built also with private capital, and it can be operated by the private sector. And it's going to be funded through a combination of private activity bonds, which is a great way for the private sector to get access to tax-exempt and financing and be, therefore, competitive, on a cost perspective, but also be

able to deliver the benefits that the private sector can on the construction and the operation side.

Senator THUNE. OK, appreciate that.

My time's expired. Thank you, Mr. Chairman, for just letting me barge in.

Senator WARNER. Thank you, Senator Thune.

I'd just want to make three quick points before I move to Senator Blumenthal.

One is, earlier comments would be—I think there's real consensus amongst all those of us who have been having conversations of no diversions from the Highway Trust Fund. Second, any kind of authority would have to have enhanced rural components. And, three, actually, the former Governor of Indiana, Governor Daniels, I think, has—Senator Coats, who's not here, has been part of the discussions—I think he's going to be putting in writing some of his ideas about how this new idea around an authority might work that might be helpful, as well.

Senator Blumenthal.

STATEMENT OF HON. RICHARD BLUMENTHAL, U.S. SENATOR FROM CONNECTICUT

Senator BLUMENTHAL. Thank you, Mr. Chairman. And thank you very, very much for having this hearing and for your leadership, Senator Warner, in advancing this idea of an infrastructure financing authority.

And I will say that I'm very familiar with the Connecticut work done by Mr. Dove, not only as a former State official during the time that some of these agreements were negotiated, but also now, as a consumer, every day, literally every day that I'm back in the state of Connecticut, stopping at one or another of the rest areas that are tremendously enhanced as a result of the $130 million that has been invested; and also very pleased that the benefits are not going to be only in the area of enhanced services to consumers, but also in revenue and jobs for the state of Connecticut.

So, I think that there is a model here that can be followed. And maybe just let me ask Mr. Dove, as an initial question, from the investor standpoint, how are things going? Are you satisfied with the progress, with the rate of construction? Obviously, the rest areas are still under construction in a number of those places, and maybe you could just give us a brief progress report, from your standpoint, now that it's in the implementation stage, not just the conceptual or design stage.

Mr. DOVE. Thank you, Senator Blumenthal. I would say that, by the end of this year, 17 of the 23 rest stops will have been either renovated or rebuilt.

One of the big risks that we took on, and was a subject of much debate when you were the attorney general, was the environmental risk. It was shocking, the environmental risk that we found, and that has delayed our progress. But, that's our risk on the private side.

The other thing which I would say is that we started this project as the state of Connecticut's economy was slowly moving out of a very difficult period of time. Now the state is doing particularly well, and we're finding that construction costs are higher as we get

to the end than they were at the beginning. So, that's another risk that we're having to undertake.

Now, I think we're going to be okay. And if we're not, then I have to, as they say, suck it up and just pay. But, that's the terms of the concession.

More rewarding for you and for me is that—the dramatic improvement in revenues once you have renovated these sites. For members of the Committee, these were sites which had a very old McDonald's concession on them, and a Mobil gas station. They have been renovated, now, on 95, to have a choice of up to eight different suppliers of food and beverage. The revenues that we're earning now are—from the food and beverage side is significantly above what it was before, and above our projections, which allows us to share that revenue with the state of Connecticut.

The amount of gas we're selling is not as high as we thought it would be. That is mainly because vehicle miles traveled is reduced, and cars—less cars are traveling. But, I would comment that we do actually now have two Tesla stations in each one of these service plazas. So, even though we don't make any money off the gas, they are—the environment is getting better.

Senator BLUMENTHAL. And the environmental risk, just so the Committee is fully informed, resulted from the contamination of the ground as a result of the previous gasoline——

Mr. DOVE. Right.

Senator BLUMENTHAL.—servicing and stations that were there for decades, literally.

Mr. DOVE. Thirty years, plus, yes.

Senator BLUMENTHAL. And the state of Connecticut—I know from personal experience, because I insisted on this point——

Mr. DOVE. Capped.

Senator BLUMENTHAL.—was very, very insistent that the investors bear that risk. And so, one of the results of this private-partner—public-private partnership was, in fact, a risk-sharing arrangement that was very beneficial to the state and its taxpayers.

Mr. DOVE. Yes, sir.

Senator BLUMENTHAL. On the subject, by the way, of renovating or rebuilding, I would offer the term "transforming" as a better way to describe what has happened at those rest areas, because I think that they have been really brought up to date in a way that is very powerfully reflective of the private sector's influence. I'm not sure, if they had remained under the control or operation of the state of Connecticut, that we would have those new vendors, with the new products that are being offered. But, because of the interest in revenue-creation, I think the state itself benefited from the increased revenue that you've identified.

Mr. DOVE. Yes, sir.

Senator BLUMENTHAL. Let me just ask one last question, and that is, do you think this model is applicable to other infrastructure projects, such as rails, bridges, roads, and so forth?

Mr. DOVE. I do. I do, because, as you will recall, we did not give any money up front to the state, but we went for the revenue-sharing model. And I think that is the way, because—I keep coming back to the same point—successful private-sector investment requires partnership with all the different stakeholders. So, doing

that in the rail sector or doing it in the port sector, having some sort of revenue-sharing is a way where everybody gets aligned.

And I just would add that the infrastructure financing authority, I think, brings us all together.

Senator BLUMENTHAL. Thank you.

Thank you, Mr. Dove, and thank you, to all the members of the panel, for being here. This hearing has been very insightful and informative. Thank you.

Thank you, Mr. Chairman.

Senator WARNER. Thank you, Senator Blumenthal.

Senator McCaskill.

STATEMENT OF HON. CLAIRE MCCASKILL, U.S. SENATOR FROM MISSOURI

Senator MCCASKILL. Thank you.

I'm very supportive of the Chairman and Ranking Member's outline of their legislation that they are proposing, but I do think it's important that we're very candid with the American people about what this is. And I have noticed that we've talked an awful lot about attracting private investment and—but, the word "tolls" have not been said very often today. And obviously, with maybe the exception of the rest area partnership, where there is, potentially, other revenue streams, that is primarily—am I correct?—the venue stream that we're referring to would be tolling?

Mr. DOVE. It's some form of a user fee. It could be tolling, but it could also be an availability payment or——

Senator MCCASKILL. What does that mean, "availability payment"?

Mr. DOVE. So, if the state—for instance, in Florida there has been a number of transactions where there has been new roads built, where the state basically underwrites that there would be so much of the revenue provided from state resources, and the balance would have to come from the private sector. So, if we——

Senator MCCASKILL. But, what would be the revenue stream that the private sector would realize there? I mean, what would be the return on investment to the private sector——

Mr. DOVE. Well——

Senator MCCASKILL.—if it was not tolling?

Mr. DOVE. It's not—if it's not tolling, it's just the availability payment.

Senator MCCASKILL. So, the State government just pays them.

Mr. DOVE. Through—but, they transferred the construction risk and also the operational risk of the road, or whatever the asset is——

Senator MCCASKILL. OK, I'm trying to——

Mr. DOVE.—to the private sector.

Senator MCCASKILL.—get to what the euphemism "availability payment" means. Does that mean that the state agrees just to pay the private entity X amount of dollars?

Mr. OFFUTT. That's right. So, basically, the concept would be: if it can be proven that the private sector can build that specific project cheaper, in terms of total cost, and quicker, then the state would make a payment—subject to usual annual appropriations—a payment that is known over the period of the concession.

Senator MCCASKILL. Oh, like the differential. Like you—the state would pay them the amount that they would have saved by having them build it? Or——

Mr. OFFUTT. No, no, it would still be a net benefit for the State; otherwise, it wouldn't make sense to do it. But, it would be something which would be agreed to up front so the private sector could model that they're not concerned about how much traffic is there, they're not concerned about if there's a toll, at all. If certain amount of millions of dollars, let's say, are paid annually, they'll spend billions, up front, to build it, and then to spend all the money needed to operate at a certain standard.

Senator MCCASKILL. So, these partnerships are occurring other places without toll roads?

Mr. OFFUTT. They are. Sometimes—because, depending on who the users are, tolls may not be appropriate. And so, as a result, if it's important for the region, then it can be done through a State DOT——

Senator MCCASKILL. OK.

Mr. OFFUTT.—as a—conduit from a funding source.

Senator MCCASKILL. OK.

In the rest area, what is the return on your investment? Is that because you all get the revenue from the gas stations and the—and you get the lease payments from the Dunkin' Donuts and Subways?

Mr. DOVE. It's a revenue-based formula, whereby the concession company, which Carlyle has an investment in, along with other outside investors, gets a percentage of the revenue, and that's then shared with the State.

Senator MCCASKILL. OK.

Yes, because, I mean, I—we're going to have to do this. We're going to have to get some private investment, because it doesn't appear to me that we're going to be able to step up to our infrastructure requirements in this country with all public money. And so—but, I do think it's important.

My daughter went on a trip across the country in a car, not too long ago, and she called me from the road and said, "Is Missouri the only state that doesn't have tollroads?" And I said, "Well, I don't know. We might be one of the few left that doesn't have any tollroads."

And so, in my state, this is, you know, kind of crossing the Rubicon, because we've not had any tolling, even though most of the surrounding states have, and we are in desperate need of more investment in my state, because we have—we're number 10 on the list of deficient bridges, and we have over 5 million people on those bridges every day that have been ruled deficient. So, it is very, very important that we find a new way forward.

I am also concerned about how we make sure that we find the right partners. If we're going to allow—in most of these instances, are the private entities actually running this infrastructure and maintaining it after it's built?

Mr. OFFUTT. That's right. The procurement process would start with the qualification stage so that anybody that you would actually have bid on the project would have to qualify, from that standpoint, to be able to operate and maintain whatever the infrastructure asset would be.

Senator MCCASKILL. In one of my old jobs, when I was prosecutor, we had some trouble with this area when we went to this model in corrections, building jails. We had a problem with some of that. So, I want to make sure that we cover that.

And finally, how do we address—I know the Chairman talked about this in his opening statement, but how do we address the fact that the revenue streams are clearly going to be deficient in the rural areas? And, other than setting the limit lower, in terms of what can be borrowed, how do we attract private investment to the rural parts of my state, which are in desperate need of investment as it relates to their roads and bridges?

Mr. BASSO. Senator, I think—with the rural areas—and I think we all recognize that—one of the things that's missing is really the deep revenue streams to go forward. You have limitations. However, I think mixing some subsidies, for example, interest rate write-downs, things like that, that make a project more feasible and more affordable in a rural area, is possible. And, in fact, in my days at ASHTO and USDOT, I've seen these done, so I know, as a practical matter, they can be worked out, but they require very careful thought and a very careful plan and a realistic expectation of how all of this is going to work and what the volumes will be that produce the revenue streams.

Senator MCCASKILL. Yes, I can see a gold rush for some parts of my State, in terms of infrastructure, and then I could—think I would hear crickets——

[Laughter.]

Senator MCCASKILL.—in other parts. And so, I want to make sure the part where people enjoy hearing crickets don't get left behind, because they've got to move their agricultural products to support the economy of our state. That's essential.

Thank you. Thank you——

Senator WARNER. And I would simply, before we move to—thank you, Senator McCaskill—Senator Ayotte—that the rural areas are never going to have that expertise on their own, or a rural state is never going to have that capacity on its own. It is by having that concentration of expertise, and layering in—this may not be the total funding source; chances are, many of the projects in rural areas would have traditional funding. But, because you'd have the ability of this financing authority to provide that kind of long-term, you know, 30- to 40-year financing on top of the traditional sources, and any project would have to be investment-grade quality with an independent oversight—you know, one of our big concerns, where we raised, earlier on, was—at this point, oftentimes I don't think the public sector has the expertise to go toe-to-toe with the private-sector guys, and sometimes taxpayers are left holding the bag. That's not what we want to repeat.

Senator Ayotte.

STATEMENT OF HON. KELLY AYOTTE, U.S. SENATOR FROM NEW HAMPSHIRE

Senator AYOTTE. I want to thank the panel and, obviously, Senator Warner and Senator Blunt for holding this hearing.

Just to follow up on what Senator McCaskill had just asked you, I mean, if you look at the numbers put out from CBO, most of the

current highway spending actually would account for projects that are too small to meet the minimum requirements that are being proposed for an infrastructure bank. You know, I know that the proposal set the minimum at different levels, whether it's 100 million or 25 million. And I think about—regardless of rural issues in New Hampshire—because we have rural areas, but we're a small state, so many of our projects, in general, are going to be smaller. And so, I guess I'm trying to understand, you know, what is the benefit for smaller states for an infrastructure bank, and how could it work for these smaller projects, to follow up on the concern, I think, that Senator McCaskill raised?

The other issue that I wanted to get your thoughts on is, I—as I understand it, many states already have their own infrastructure bank. In fact, I think the numbers are that there are 36, but 22 are active right now. How does the layer of a Federal infrastructure bank not actually——

Senator WARNER. Authority. Authority.

Senator AYOTTE.—authority for a Federal infrastructure bank not take away from some of the projects that are already really being done at the State infrastructure bank level? In other words, what we don't want to do is create another situation where somehow this authority cherry-picks from what's already being done at the State level.

Mr. BASSO. On the State infrastructure banks, your numbers are right on point. The real origin of those, though, just to give you a little history, was, in 1996 and 1997, Congress actually put out $150 million in seed moneys, which those states took advantage of to create the banks. Some of them have continued them actively, some have let them go primarily dormant.

But, I think what the Federal or the national bank would add—and it would be a complement, not, basically, a hindrance to those banks, because many of them need more capital than they can raise individually, locally. And making some connection between the capitalization of the national infrastructure fund, the State infrastructure banks, can work.

And I've also seen, in my experience in those days, multiple states come together with their banks and pull pools together with the national, which the national infrastructure fund could do very effectively.

So, I think it's a complement, actually.

Senator AYOTTE. What do you think about CBO's recent report that said—that looked at infrastructure banks and said, basically, that they didn't think, for water and energy facilities, that this may be needed to finance those types of projects because of the availability and stability of revenues generated by users on water and for energy facilities? So, I'm just thinking, as we look at the structure here, what are your thoughts on what the CBO said about that?

Mr. BASSO. Well, I think this. I think, on water—having, again, dealt with some of those issues over the years—I think there is potential there. I think it's—depends on whether—how you set up, basically, the revenue streams coming from water that can move forward and make some improvements that dramatically need to be made.

With regard to energy, I think there are different segments of energy that can be addressed. Now, those are probably not as effective to address. So, I think it really is a—something you want to look at, on a case-by-case basis, as you structure.

Senator AYOTTE. And——

Mr. MINETA. And, Senator, I—if I might also add——

Senator AYOTTE. Oh, of course.

Mr. MINETA. It seems to me the 18.4-cent Federal tax that we've had since 1993, even with vehicle miles going up, with the CAFE standards going—rising—revenues into the Highway Trust Fund, as we all know, are going down. So that states with their own gasoline taxes, or now they supplement the State gasoline tax with sales tax on gasoline at the State level and at the local level. California, you have California State gasoline tax, you have a sales tax on the purchase of gasoline, and then you have each of the counties having a local option of adding their own sales tax to the gasoline cost.

The problem, I think, right now, is that all of these sources are not keeping up with all of our needs. The question is, where is it going to be coming from? And I think that's where the Chairman's authority is going to be able to enhance the private sector to come in and do that.

Senator AYOTTE. Yes, I don't dispute that. I just want to make sure that, if we go forward with this, that we're, obviously, addressing for smaller-type projects, which are a majority of the projects that are currently going forward on transportation, and we're thinking, as well, as making sure that, when states have put in their own structure, that we've—we're accounting for that structure so that we continue to allow them the flexibility that they need with resources that they've already—ideas that they've already had.

So, I believe that we have a need for infrastructure in this country. And so, I want to make sure, though, in a state like mine, that we get it done right so it will benefit New Hampshire and not just be another layer of—you know, another Federal piece that isn't effective in really delivering on what it purports to deliver.

So, I thank everyone for being here today. I think my time's expired.

Thank you.

Senator WARNER. I want to thank Senator Ayotte for her comments, and I want to just—some of the conversations Senator Blunt and I have been having, and I can assure you, Senator Thune is—urged us, as well—is that some of the previous proposals that had a—say, a $25 million minimum, have been cut dramatically, down. Number one.

Number two, this is not—I mean, I think, echoing what Senator McCaskill said—you know, some source—this is not free money. It's got to get paid for. And this is not a solution set, this is just one tool that every other industrial—major industrial country in the world has in their toolbox. And by no means would it supplement or replace good programs at the Federal level, like TIFIA, good investment banks at a State level—I don't know if New Hampshire's got an investment bank. But, time and again, the

complexity of these projects gets such—if you've got a local interest, a State interest, you may have a private layer of capital.

And, candidly, smaller states are at an even bigger disadvantage. Virginia's been one of the leading states on the cutting, and sometimes bleeding, edge, because we've made some mistakes along the way. And part of that, I think, was because we didn't have the expertise, at the State level, to really make the judgment of whether we were getting an investment-grade product.

And one of the other things I would simply add, that any such entity or authority that I'd want to see us look at or examine would have to be independent of whomever was in the running administration. This has to be done with investment-grade criteria. And having that expertise, where people could come for a career and perhaps not get quite as well compensated as Mr. Offutt or Mr. Dove, but at least be able to go toe-to-toe with some of our private-sector competitors.

My fear is, right now, like on what Senator McCaskill raised, is, there are times when we've taken private sector—or, public sector has taken upfront capital, that, on a long term basis, is a bad deal. And I'm not sure we've got that expertise to go toe-to-toe at this point. But, that's part of this discussion.

And I want to thank the panel for very, very good input. I want to really thank my colleagues for their participation.

And, with that, the hearing is adjourned.

[Whereupon, at 4:10 p.m., the hearing was adjourned.]

A P P E N D I X

PREPARED STATEMENT OF JOHN A. FLAHERTY, MANAGING DIRECTOR, CAPITAL NETWORK PARTNERS AND JILL EICHER, MANAGING DIRECTOR, THE FIDUCIARY INFRASTRUCTURE INITIATIVE

Mr. Chairman and Members of the Subcommittee please accept our thanks for allowing us to submit this testimony for the hearing.

We would like to congratulate the Subcommittee for its work on infrastructure financing and specifically your efforts to create a national infrastructure financing authority. We believe that such an entity would significantly increase the capabilities of state and local government entities to use heretofore untapped resources for their infrastructure projects.

We also believe that the sponsors have worked hard to create a properly designed Authority which will avoid the chief concerns that many Senators and Representatives have cited in the past—how will rural communities continue to benefit from Federal funding policies; and will Members of Congress elected to represent their constituents and ensure the economic strength of the Nation cede too much authority to a bureaucratic structure.

Interim Steps Can Be Taken Now by the Federal Government

While structures like the Financing Authority are being considered, the Federal Government—including this Subcommittee—can take steps now to develop a model that can be used to start building infrastructure projects now, and would create momentum to create a successful national Financing Authority.

In order to get a widespread successful model of direct investment the Federal Government should move decisively in two specific areas.

First, the Federal Government must make greater and more efficient use of its existing financing tool. Federal agencies must take their existing financing structures and use them to leverage and reward innovative projects that are brought to them by that state and local governments working with other partners. The Department of Transportation should increase the resources and elevate the management of its effort including the TIFIA process. TIFIA is a victim of its own success and many observers are concerned its dedicated staff is overwhelmed and under resourced. Direct investment and supporting innovative financing models should be made a genuine priority in the Department. Also in other agencies—the Environmental Protection Agency, the Department of Commerce, the Department of Energy, and the Department of Agriculture—all of them should be asked to review their existing funding mechanisms and see how they can be adapted to encourage innovative financing for infrastructure.

Second, the Federal Government has an important role to play as validator in creating successful partnerships that go beyond funding mechanisms. The Federal Government should not wait for the investors and state and local governments to develop projects. They should be helping to put these important stakeholders together, looking for ways to support efforts by local and state governments to develop these projects, and seeking out financial partners, engineering and construction firms that want to participate. There are several state and local entities—state infrastructure banks, regional water authorities, rural county organizations, and others that would benefit from active Federal outreach. A set of signals from Federal agencies to their constituent stakeholders is critical, and putting time and resources into this effort will encourage the development of these projects.

Other Stakeholders Must Join In A Working Model

Three other stakeholder groups must be willing to join in active partnerships to build infrastructure in order for the Federal Government's actions to reap benefits.

State and Local Governments Must Step Forward

First, state and local governments must step forward to help identify projects in their states and localities which can benefit from direct investment. There are many

ways that state, local, and regional authorities can identify projects and join with other partners to come up with new projects. Water facilities can be consolidated and made more efficient and capacities expanded. Availability payment models can be employed to rebuild bridges throughout a state, reliable micro grids can be built, 9/11 centers can be constructed, and pipelines that transport energy products and water can be built. Mr. Chairman, you were a pioneer in this effort as the Governor of Virginia, and there are other leaders in our nation that can provide their time, policy and political support.

Engineering Firms, Construction Companies, and other Strategic Partners

A second important group is the strategic infrastructure companies. Engineering firms and construction firms have a critical role to play in developing these infrastructure projects. These firms can contribute to a strong partnership by working with state and local governments—who are often their clients in building and/or operating their current infrastructure assets. These strategic infrastructure companies need to play a larger role in developing projects with state and local governments that can attract the right type of direct investment and give Federal authorities confidence that the components of a successful infrastructure project are there.

Pension Funds Have a Key Role to Play

The third group that must step forward to build a working partnership for infrastructure projects using innovative financing are the public pension funds. We believe two important reasons the "P3 market" has not developed is political risk and expensive money.

First, state and local officials have been reluctant to turn over public assets to a private financing entity. Rightly or wrongly, they fear they can be criticized for "privatizing" public assets. The political risk often is calculated to be too high, or "off-ramps" are included in the process that makes it too risky for the private sector to invest in a project. Groups that oppose direct investment can gain traction by capitalizing on fears that elected officials are turning over public assets to "Wall Street."

Second, many of the prospective financing partners require a return on investment that makes using their money too expensive. Private sector partners have a great deal to offer a partnership. They incorporate several characteristics into a project that public financing frequently does not include—life cycle costs, a strong on-site presence, stronger accountability for deadlines and budget discipline.

Yet, in several instances state and local authorities conclude that the money offered by these financial entities is too expensive. The return on investment for a private sector investment fund often must be in the double digits in order to make an acceptable return to their investors. While the efficiencies they bring to a project's partnership are highly desirable, the financial cost of their money is too high. Either the Government entity chooses another funding option, or the financial partner concludes that the project will not pass their investment committee.

We believe pension funds becoming equity partners can become transitional agents in the effort to get more direct investment in infrastructure projects. Currently, many pension funds are invested in infrastructure funds, however many pension fund officials are beginning to look at the opportunities that may exist for their funds to become direct investment partners in infrastructure projects.

Pension funds interest in investing in infrastructure assets is fueled by an acute need for predictable, long-dated income. As return expectations for fixed income investments have declined from 5–7 percent to 3–5 percent, institutional investors have correspondingly reduced fixed income asset allocation levels from 30–40 percent to 20–30 percent. The median allocation to fixed income for public pension funds is currently 26.8 percent. This shift reflects the widespread view among institutional investors that a prolonged bear market in bonds will unfold over the next decade as interest rates move higher and developed countries remain mired in debt. This shift has necessitated a search for bond alternatives, which has led institutional investors to consider core infrastructure assets, *i.e.,* those with strong operating histories and contracted, inflation-linked cash flows, to replace income traditionally generated by fixed income investments.

On April 16, the Fiduciary Infrastructure Initiative convened a roundtable of 12 public pension fiduciaries representing over $850 billion in capital to discuss their views towards infrastructure, specifically current product offerings, return expectations, allocation levels, and investment experience to date. The group represented large, medium, and small pension funds, as well as state/municipal and public/union funds. Pension fiduciaries expressed an eagerness to determine whether there is a pipeline of projects that would meet their investment criteria.

Against an industry median 7.8 percent assumed annual rate of return and a negative outlook for fixed income returns over the next decade, the potential income and return potential of long-lived physical assets is compelling. Moreover, recent market performance revealed a mismatch between the volatility of equities and the bond-like nature of pension liabilities. While fixed-income investment vehicles are better matched against pension liabilities, the average duration in fixed income portfolios has been much shorter than most plan liability durations, thus producing significant exposure to interest rates.

Recognizing this exposure has heightened public pension interest in employing inflation linked, cash yielding infrastructure assets to offset interest rate exposure. This has also led to a shift in thinking about the optimal role for infrastructure in a pension fund portfolio. Instead of utilizing infrastructure as part of a pension fund's alternatives portfolio with a 12–15 percent target IRR, fiduciaries now see a more nuanced role for infrastructure as part of their fixed income or liability-matching portfolios targeting 4–8 percent real rates of return.

The performance imperative articulated demonstrates public pension interest in infrastructure and is further supported by increasing asset allocation levels to infrastructure. We estimate that our roundtable participants and interested fiduciaries have approximately $50 billion of equity capital to deploy into infrastructure. It was noted that international pension fiduciaries have realized attractive returns in infrastructure investments by investing collectively. The returns realized by these pension investment collectives are compelling pension fiduciaries to take a hard look at the value proposition of direct ownership of core infrastructure assets.

It is challenging, however, for pension funds to make direct investments due to their restrictive budgets and limited resources. Only two U.S. public pension funds have made direct investments in infrastructure assets to date. In 2009, the Dallas Fire and Police Pension System invested in the Dallas/Fort Worth I–635 highway managed lane project. In 2010, the California Public Employees Retirement System (CalPERS) took a 12.7 percent equity stake in Gatwick Airport. In 2012, CalPERS made its second direct investment in a 65-mile underwater power transmission line between New York and New Jersey.

We believe that may be changing. Making direct investments on a collective basis, however, could facilitate programmatic objectives and achieve economies of scale. Several Roundtable Participants have allocated capital to an Australian investment collective, Industry Funds Management (IFM), which is owned by 32 Australian superannuation funds. It was also noted that the United Kingdom is developing an investment collective based on the IFM model. The UK government is encouraging the collective platform to invest in in-country infrastructure through several legislative policy initiatives and incentive programs.

Conclusion

Mr. Chairman, and Members of the Committee, we believe that a model currently exists that can help begin a series of infrastructure projects throughout the country and across different types of critical infrastructure—transportation, water, energy, and emergency telecommunications.

A set of strong partnerships are needed. The partnerships must include: (1) innovative state and/local leadership, (2) expert engineering and construction firms, (3) public pension funds and community banks providing needed equity at acceptable return rates; and (4) Federal agencies providing existing debt mechanisms and strong project support on the political and policy fronts.

Each partner is essential to the project. And each partner has a critical role to play in supporting the efforts of the other three partners.

We respectfully request that the Subcommittee support the development of these partnerships. And we believe that as these partnerships develop, and successful projects are started in urban, suburban, and rural regions of the country, a national infrastructure financing authority will garner additional support from constituencies across the political spectrum.

Thank you for giving us the opportunity to submit this testimony and we look forward to working with the Subcommittee in the future.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BRIAN SCHATZ TO ROBERT DOVE

Question 1. The Carlyle Group has been a partner in a number of projects financing real estate investments in proximity to current or planned public transportation hubs. The City and County of Honolulu are planning for transit oriented development around new rail stations Honolulu Rail Transit Project. How can transit ori-

ented development public private partnerships help communities capture a return on transit investment?

Answer. I regret that this is not my area of expertise, but Carlyle would be happy to set up a meeting with you and our real estate development experts to discuss this specific topic.

Question 2. In Hawaii, we are constructing the first rail transit in the state, the Honolulu Rail Transit Project. Transit oriented development (TOD) infrastructure along the corridor could help a return on investment, increase ridership, and generate significant economic development. In testimony, you noted that a Federal financing authority is a way to tap into innovative financing and renew infrastructure investment. Public entities have paired with the private sector to generate TOD—some public-private partnership examples include Portland's Pearl District and more recently, the Denver Union Station. How could a Federal financing authority, such as an infrastructure bank, facilitate public private partnerships to build infrastructure that supports transit oriented development?

Answer. Assuming that the project is credit worthy, an infrastructure financing authority will provide a large source of capital that will attract other project financing or equity.

Question 3. What other steps could be taken at the Federal level to engage the private sector on TOD projects?

Answer. Congress should take steps to reform the Foreign Investment in Real Property Tax Act (FIRPTA). This will spur billions of foreign investment in U.S. real estate debt and equity markets, help stabilize troubled domestic lending markets, create jobs and lead to economic growth.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. BRIAN SCHATZ TO J. PERRY OFFUTT

Question 1. In Hawaii, we are constructing the first rail transit in the state, the Honolulu Rail Transit Project. Transit oriented development (TOD) infrastructure along the corridor could help a return on investment, increase ridership, and generate significant economic development. In testimony, you noted that a Federal financing authority is a way to tap into innovative financing and renew infrastructure investment. Public entities have paired with the private sector to generate TOD—some public-private partnership examples include Portland's Pearl District and more recently, the Denver Union Station. How could a Federal financing authority, such as an infrastructure bank, facilitate public private partnerships to build infrastructure that supports transit oriented development?

Answer. Assuming the TOD project can achieve an investment-grade credit rating (either via a credible ridership study or contracted "availability payments"), any material funding from a Federal finance authority would help attract private sector capital. Like any infrastructure development project, it is important to keep the funding cost as low as possible. A significant contribution from a Federal finance authority could materially lower the total cost of capital to build such a project.

Question 2. What other steps could be taken at the Federal level to engage the private sector on TOD projects?

Answer. Both the Eagle P3 project in Denver and the proposed Purple Line in Maryland are transit projects that are not projected to generate enough revenue to adequately compensate the private sector to design, build, operate, maintain and finance the projects. As a result, both projects decided to use "availability payments" (as defined in my written testimony) to help finance the project.

Since many states or local governments are not familiar with the use of "availability payments" to finance projects, I believe that the Federal Government could be a repository for such information so that could be disseminated to various transit authorities.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN THUNE TO J. PERRY OFFUTT

Question 1. With the creation of any new program there is always startup time. Do you have any estimates on the amount of time it would take to get the first dollars out the door if a new infrastructure financing authority was created? Do you envision all the applicable Federal regulations also applying to such new programs and structures?

Answer. I do not have an opinion on this.

Question 2. As you know, the private sector can often complete projects more quickly and efficiently than the government. If an infrastructure authority was created, do you believe that this would still be the case? If so, by what rough percentage in improved project delivery do you envision infrastructure projects being completed? What types of projects do you foresee being most attractive to investors?

Answer. If the infrastructure finance authority is able to review opportunities and invest capital in a formulaic manner based on transparent investment criteria, then I do not believe this will hinder the project procurement/investment process.

However, as I stated in my testimony, not all greenfield projects will require/desire the involvement of an infrastructure finance authority. For example, a typical DBOMF (design, build, operate, maintain, finance) P3 road project that utilizes "availability payments" can secure TIFIA, Private Activity Bond and equity financing without the involvement of an infrastructure finance authority.

Of course, there are projects of national/regional significance that would not be able to secure financing without the involvement of an infrastructure finance authority. For those projects, Federal involvement is critical.

For the investors that I spend the most time with (pension funds and infrastructure funds), medium to large water and wastewater systems that need significant capital investment would be of particular interest. These opportunities would offer the private sector the ability to invest in a regulated asset that needs its private-sector expertise and significant capital.

Question 3. The Simpson/Bowles Commission has recommended that the Federal gas tax be increased, or alternatively, indexed to inflation. What are your thoughts on this recommendation?

Answer. I do not have an opinion on this.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN THUNE TO PETER J. BASSO

Question 1. With the creation of any new program there is always startup time. Do you have any estimates on the amount of time it would take to get the first dollars out the door if a new infrastructure financing authority was created? Do you envision all the applicable Federal regulations also applying to such new programs and structures?

Answer. In response to the question on start-up time while standing up a new entity can take time I expect that if the legislation is promptly enacted and the initial funding provided than with a full effort the entity could be operational within one year. This is a ball park estimate and the details will need to be better known to be more accurate.

I do assume that most Federal requirements would apply to the entity.

Question 2. As a former director of the American Association of State Highway and Transportation Officials, you understand the funding challenges faced by states. What options do states have to generate revenue to fund infrastructure programs that they are not currently availing themselves of today?

Answer. Actually most states utilize a combination of dedicated user fees (fuel taxes and registration fees), tolling to some degree and bonding to invest in infrastructure.

The financing side of the equation includes GARVEE bonds, TIFIA loans and in about two thirds of the states to some degree State Infrastructure Banks. The broad categories of user fees, bonding and credit programs are likely the full range of state options to finance infrastructure. So in my view there is no unturned stone that would solve our infrastructure underinvestment problem.

Question 3. The Simpson/Bowles Commission has recommended that the Federal gas tax be increased, or alternatively, indexed to inflation. What are your thoughts on this recommendation?

Answer. In the short run for Federal funding the most immediate revenue raiser would be the Simpson/Bowles proposal; therefore I support it because of the critical condition of the Highway Trust Fund.

However, it is also clear that given the reports from the Congressional Budget Office on the impact of CAFE standards and the minimal growth of VMT that there is a requirement for a long-term solution. One option might be to pilot test mileage based user fees as a way to meet our long-term revenue needs.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN THUNE TO ROBERT DOVE

Question 1. With the creation of any new program there is always startup time. Do you have any estimates on the amount of time it would take to get the first dollars out the door if a new infrastructure financing authority was created?

Answer. Without knowing the exact structure of the entity, it is difficult for me to provide an informed opinion.

Question 1a. Do you envision all the applicable Federal regulations also applying to such new programs and structures?

Answer. I would prefer to hear all the specific Federal regulations that this encompasses before I respond.

Question 2. As you know, the private sector can often complete projects more quickly and efficiently than the government. If an infrastructure authority was created, do you believe that this would still be the case? If so, by what rough percentage in improved project delivery do you envision infrastructure projects being completed?

Answer. An infrastructure authority could help close the time gap. The private sector is just more nimble, able to move more quickly. An infrastructure authority that operates independent of Congress should help close the time gap that exists between completion of Federal project and private projects.

Question 2a. What types of projects do you foresee being most attractive to investors?

Answer. Projects with associated cash flow or contracted revenue are the most attractive. This is the arrangement that attracted Carlyle to the successful Connecticut public-private partnership that I referenced in my testimony.

Question 3. The Simpson/Bowles Commission has recommended that the Federal gas tax be increased, or alternatively, indexed to inflation. What are your thoughts on this recommendation?

Answer. My expertise is private capital so I leave this question to the tax experts.

RESPONSE TO WRITTEN QUESTIONS SUBMITTED BY HON. JOHN THUNE TO BURT WALLACE

Question 1. With the creation of any new program there is always startup time. Do you have any estimates on the amount of time it would take to get the first dollars out the door if a new infrastructure financing authority was created? Do you envision all the applicable Federal regulations also applying to such new programs and structures?

Answer. No, UPS does not have any estimates on how long it would take a new infrastructure financing authority to get up and running, but is keenly interested in finding out the timetable for such an apparatus, if one was indeed created. Generally speaking, we are supportive of the concept, but would need to analyze and consider the details of such a program, including the applicability of Federal rules and regulations related to the funding mechanism.

Question 2. The Simpson/Bowles Commission has recommended that the Federal gas tax be increased, or alternatively, indexed to inflation. What are your thoughts on this recommendation?

Answer. UPS strongly supports increasing the Federal motor fuel tax on gas and diesel fuel, with the *key caveat* being that all new funds generated by the fuel tax increase be directly reinvested into the nation's surface transportation infrastructure (*i.e.*—the Highway Trust Fund), and not siphoned off for other non-transportation programs. If it is not politically feasible to increase the fuel tax, indexing the motor fuels tax to inflation should be pursued.

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